Colin Bloodworth looks at the how to find a plan that suits your needs and budget

Choosing the Right Policy For Life Insurance

Last week we reviewed the importance of life insurance. We also saw how the amount of cover needed can be seriously underestimated. For someone with a young family a figure equivalent to 10 times annual salary may still not be sufficient to compensate the loss of the breadwinner.

We also addressed the dangers of delaying a decision to take out insurance. Not only do premiums rise rapidly with age but should a serious illness or accident occur while you are uncovered, the insurance companies may no longer wish to know you. So having agreed that action is called for where do you start?

Ideally, the exercise should start with a calculation of how much your family would need in terms of a lump sum to generate an appropriate income. This would include a projection of the cost of seeing your children through their planned education. You can obtain quotes from insurance companies to see what this would cost.

If the above exercise produces a premium that is beyond your means then you will need to take a more realistic approach to determine how much you can actually afford to pay. There is no point in paying a premium that could become a serious burden or which you are unable to maintain, resulting in the policy lapsing. Fortunately there are two main types of insurance, one of which is less costly.

Whole of life

This is a form of insurance where after two or three initial years part of your premiums are invested in stocks, bonds and similar assets. The policy then starts to have an investment or surrender value. If you maintain the policy over a number of years, typically 15 to 20, the surrender value could be in excess of the premiums you have paid. In fact, if your premiums are sufficiently high and the investment performs well you could build up a sum to the point where it can continue to fund the policy and you do not need to pay further premiums.

There is however a factor that is working against you and that is your age. Even though the premiums remain the same the actual cost of insuring you rises every year so that a greater call is placed on the underlying investment. If the latter is not growing fast enough the cost of coverage could swallow up the remaining funds to the point of exhaustion. At this point the policy would terminate or you would have to agree a higher premium. Ideally this should not happen and the policy should sustain itself for the "whole of life" as per its definition.

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Level term assurance

This is a far more economic form of cover. Depending on the term selected, which would typically be from 10 to 20 years, the fixed premium is based on the average cost of cover over the term. The downside is that the policy has no investment or surrender value. It automatically lapses without value at the end of the term. The big plus factor is the lower cost.

Term assurance is also available for just one year. This would be cheaper still in the early years but would rise sharply with each year of age so it would not be a good idea for the longer term, although it may suit someone who needs cover for a limited period.

The risk

While life insurance is well understood it is easy to overlook the risk of living but being unable to work. In certain circumstances it could be even worse if the breadwinner survives but needs expensive ongoing care.

Medical insurance is the first line of defense. It is vital to be covered yet this in itself does not cover loss of earnings. Ideally, critical illness insurance should be bolted on to life cover. This would pay out a sum of money in the event of the insured suffering one of a list of critical illnesses, including the most common ones of stroke, heart disease or cancer. Considering that more people actually suffer a critical illness and survive than actually die before the age of 65, there should be a greater awareness of critical illness.

Striking a balance

At the end of the day, everyone has to determine how much they need to live comfortably and how much should be allocated to protect their way of life, not forgetting also the importance of saving for the future. All of which makes financial planning an important and challenging task.

Colin Bloodworth, director of PPI Indonesia, has spent over 20 years in Indonesia. If you have any questions on this or a related subject you can contact the writer at indonesia@ppi-advisory.com