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Season 1. Taking more control of your money

Episode 7.

Insuring your greatest asset, you

Hi there, Jason here, and in this Insight we're going to talk about insuring your greatest asset which is, of course, you. We'll explore a powerful way to think about what you're really worth, in financial terms. We'll look at the risks to your health and your life that you might want to insure against. And, we'll look briefly at what it might cost to cover those risks too. As always, you'll find more information on this Money Insight on the resources page of the Salary Finance Website.

Now, let's try a thought experiment try to imagine you and a very close friend are having a deep and meaningful discussion about the value that each of you brings to the world. Yes, I know, it's not a typical discussion but if it were to happen, what do you think you'd talk about? Well, perhaps you'd talk about your value as a friend to each other and, if either of you are parents, the value you give to your children. Or your value as carers to any ageing parents. Also, I expect you'd talk about the considerable value you add to your employer through your daily efforts at work.

And, if you are numbers type people, you might even talk about your financial net worth, which is the value of everything you own, less the value of your debts. Or, to put that another way, it's what you could walk away with if you decided to sell up and live on a desert island somewhere. Although, as we start out on our wealth building journey, with a big mortgage and other loans it might be a negative number!

But here's the thing, whilst these are all great ways to think about what you're worth, they simply don't describe your greatest financial value. Which unless you're very close to retiring fully from work, will come from your future earnings potential. And you'll be surprised how much you're worth when you think of your value in these terms. You see, if you work to earn some or all of the money you need to pay the rent or the mortgage on your home and the other bills and the luxuries, like holidays too. And you add that all up for many years into the future, the financial value you will add to your own life, and any loved ones you help to support, is really quite staggering.

It's rather like you are an incredible money-making machine which, in part, of course, is what we all are. Now let's take that idea a little bit further to see what your earnings are worth. Imagine you could go to shops today and buy a machine to regularly produce the money you currently take home from your work. How much would you pay for a machine like that?

Well let's look at an example. And let's say you have realistic earnings potential of £20,000 a year for the next 20 years. In simple terms then, and taking account of your pay growing over time with inflation, you'd probably have to pay about £400,000 for a machine like that. Similarly, you'd have to pay about £900,000 if your earning potential was, say, £30,000 a year for the next 30 years. And, of course if you really could buy such a machine you'd take very good care of it. You'd also insure it against the risk of breakdowns and damage from fires and of losing it altogether, if it was stolen.

So, I'm sure you can see it makes perfect sense to insure ourselves against breakdowns and total loss too. Unfortunately, very few people do insure themselves or their loved ones adequately against a disastrous breakdown in their earnings or working capacity. And it's worth taking some time to understand the four main reasons why they don't. Many people believe that they don't earn enough for their lives or their earning ability to be worth the cost of insuring. And if you're thinking the same, have a think about how many hours of unpaid work you do each week to keep things running smoothly at home? Or, if you're not the one who does most of the home chores, think about who is doing it for you and what it would cost to pay someone else to do that work if your home maker died suddenly or became ill tomorrow?

You see, however you look at this, the chances are that you, and your partner if you have one, are a very valuable person. So, it makes sense to think hard on the money you'd need to keep everything running on the home front, whether it was you or your partner who was suddenly struck down by a serious health issue or worse. Now, I realise that it's no fun at all to think about your partner (and any children you have) being left without enough money to cope in the event of your death or care for you if you had a health disaster.

And this is another reason why a great many people do not do anything about this. They simply don't want to think or talk about it. But please don't bury your head in the sand on this issue because, whilst it's no fun for us to think about this now, it's a lot less fun for the people we leave behind trying to cope with less money than they need. So please look at your plans to cover these risks, before it's too late. Now this is a quite common misconception, and whilst the state might provide some benefits for you if you're unable to work due to serious ill health, or to your family, in the event of your death, it's important to understand that the state only provides a low safety net and this is not enough to meet the needs of most working people. State benefits are, as ever, a hugely complex area, but you can find more information on the resources page of the Salary Finance website.

Finally, one of the biggest reasons why many people don't insure their lives and health properly, is that they believe the worst will never happen to them. And whilst it's absolutely true that the chances are low of our life being cut short, or of being struck down by a life changing illness or accident, the impact of such disasters are so high that we really need a plan in place to cover the worst case if it happened. Nobody would willingly leave themselves or their loved ones in dire financial straights in such circumstances. And this leads nicely on to the good news on the cost of these insurances.

You see, it's precisely because the risk of these personal disasters is normally low that the cost of insuring against them is extremely low too.
Let's look at the cost of life insurance as an example. If you're under the age of 40 and enjoy normal levels of health, the chances of staying alive for another 10 years are 99% or more. Now, that's really quite close to a certainty. Even at around age 60, the chances of staying alive for another 10 years are 90% or more. And as a result, the cost to insure your life for a term of, say, 10 years is really very cheap. So, a life assurance policy that pays out £250,000 in the event of your death, at any time within a 10-year term, might only cost a healthy 30-year-old less than £10 per month. A similar insurance on a healthy 40-year-old might also be available for less than £15 per month.

Now obviously you'd pay more to insure against risks with a higher chance of happening. So, you'd pay more for a life insurance plan that pays out early if you suffer a serious critical illness, like a heart attack or stroke or kidney failure. Likewise, the costs are quite different for an income protection policy which would pay you a regular income if you were unable to work for a long period of time, due to sickness or disability. But the monthly cost will probably be much lower than you would pay for a typical mobile phone contract.

But whatever insurance you need, and provided that you buy it whilst you're in reasonably good health and before you get too old, the price you pay will be low for the peace of mind you get about how you or your loved ones would cope if the worst were to happen. Of course, you really won't want to have to claim on these policies. It's just nice to know they're in place if you they're needed.

Now, as always in financial planning, the types of insurance and the amount you might need will depend entirely on your personal situation and that of your partner – if you have one. We've seen here that there are different types of insurance, covering different types of risk. And what's more each type of insurance may offer slightly different features depending on which insurer you choose. And, as with any type of insurance, you need to watch out for exclusions too. It's certainly not a good idea to choose a policy only on the basis of price.

Finally, with life insurance policies it can make sense to have these set up under a suitable trust, to make sure that the right money reaches the right hands and at the right time. For example, you might not want a child to receive a very large sum before they're mature enough to handle it. And trusts can also help your loved ones access policy proceeds quickly after your death, without the need to wait for probate.

And all these points of detail should hopefully tell you that it's worth getting a qualified and competent expert to help you plan and get things set up in this area. So please take some guidance. And in the first instance talk to your employer to find out what, if any, cover they already provide you. Or what products they could offer you at a competitive cost. You can then work with an online or human adviser to decide what further insurance, if any, you need to take out.

In the next Insight, which is the last in this foundation series, I'll offer a 'round up' of everything we've covered so far. So, see you back here when you're ready for that.

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