

Income protection – sample premiums and returns

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Contractor **income protection** provides a vital source of income if a contractor has an accident or becomes too ill to work. But how much do the premiums for this essential financial survival tool cost?

"No one premium is the same, as they are dependent on each contractor's personal circumstances, including their health," highlights, [Mark McBurney](#), life and income protection expert at [Contractor Financials](#).

But McBurney and the team have put together some examples of a vanilla contractor with no health issues to cut through the mystery that surrounds this type of insurance cost and to demonstrate that the premiums are surprisingly affordable.

What type of income protection provider should contractors choose?

Firstly, contractors need to consider the provider. A financial adviser should provide guidance, but sometimes premiums can be attractively priced for a reason.

McBurney explains: "For income protection over the long term, contractors should avoid the old style mutual and friendly societies. They should be avoided as they simply lack the financial reserves.

"In this context you get what you pay for and a large provider with a well known brand is the best option, as they will be sufficiently capitalised to provide for policyholders over the long term and will have efficient processes for when a contractor needs to make a claim."

What amount and time period should contractors choose?

The next decision is for a contractor to choose how much they would need each month and after how many months they would make a claim. Essentially, these will link directly to a contractor's earnings and how much cash savings they have.

"You can only insure up to 70% of your gross taxable earnings using income protection, and most contractors choose three, six or 12 months as the time period after making a claim before payment starts," continues McBurney.

"There are one or two providers who will start paying out after a week, but this increases the premiums. At the other end of the scale, you can choose to be paid after two years from becoming ill, but these policies are not attractive to most contractors."

The longer the period, the lower the risk to the provider and the greater chance of the contractor recovering and not needing a payment, so the premiums are weighted accordingly.

How much premium a contractor can pay for income protection

"We created some sample premiums based on a contractor who is a non-smoking male aged 31 with no additional health issues seeking £1500 a month. The example premiums are as follows:

£21 per month premium for an income protection policy that pays £1500 a month after 12 months

£23 per month premium for an income protection policy that pays £1500 a month after six months

£44 per month for an income protection policy that pays £1500 a month after only one month.

"Clearly, the tipping point in premium costs is around the one to three month mark. Most contractors choose amounts of £1500-£2000 [correct at the time of writing]. If a contractor wants to insure for a much higher monthly income, then their premiums will also be considerably higher. But remember you can only insure up to 70% of your gross taxable earnings."

How do payment protection insurances actually work?

McBurney deals with many contractors who have been fed the insurance industry 'mystique' about payment protection and so are quite confused about how it all works. Actually, it is quite straightforward.

He explains: "If you have an accident or get ill, then the minute the doctor signs you off, you make a claim. If the deferred period is three months, then the provider will start paying out in month four, assuming you have not recovered by then.

"The policy does not end when you make a claim. If, for example, you have a 25-year policy to take you to retirement and you have to claim in year three, that does not stop you from claiming again in year five.

"You can also choose a guaranteed renewable premium that stays the same so you know where you stand after the underwriting has been completed.

"It is also possible to index link the policy, so the cover is inflation-proof. £2000 today is worth less than £2000 in five year's time. If you choose this option, every year the premium increases in line with inflation, but so does your cover."

What other factors affect income protection policy premiums and payouts?

McBurney notes that there are three major factors that can make an impact on a contractor's premium and potential payout: "Health is a major factor and if there is any condition that means there is a higher risk of a contractor being more likely to take time off work due to illness, it will increase premiums. This can include factors such as general wellbeing – a contractor with a high body mass index (BMI), for example, will have a higher premium.

"There is also the type of job the contractor does. Most contractors work in offices, so have low risk occupations. But oil and gas contractors spending time offshore and engineering and construction contractors spending time on construction sites can expect to pay higher premiums.

"Finally, the income protection payout is typically based on gross taxable earnings. This does not work if a contractor is working for one of the more tax efficient umbrella companies or offshore solutions because their gross taxable earnings are so low, although it does work for limited company contractors with **low salary and high dividends**."



Mark McBurney

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Mark McBurney is an experienced financial adviser, with ten years' history in the mortgage market, now specialising in protection for contractors.

Contractor Financials specialise in providing financial advice tailored to the needs of contractors and freelancers. [Read Full Profile...](#)

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McBurney concludes: "What the examples highlight is that for most contractors, income protection is easily affordable, and even for contractors with occupation or health-related issues, when compared with typical earnings a policy is a small overhead compared to the peace of mind a contractor and their family get if the worst happens and they can't work."

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