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Activity Questions

Activity 1
Define the following terms:
- Life insured
- Bundled
- Qualifying period
- Interim cover
- Level premium
- Future insurability

Go onto the internet and look at some different product providers to see if they define any of the above terms differently.

Activity 2
Define the following TPD policy wordings:

<table>
<thead>
<tr>
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<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any occupation</td>
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</tr>
<tr>
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<td></td>
</tr>
<tr>
<td>Home duties</td>
<td></td>
</tr>
<tr>
<td>Loss of limbs or sight</td>
<td></td>
</tr>
<tr>
<td>Unable to perform the activities of daily living</td>
<td></td>
</tr>
<tr>
<td>Cognitive impairment</td>
<td></td>
</tr>
</tbody>
</table>

Activity 3
Explain the purpose of trauma insurance with reference to its introduction.
Activity 4

A policy has a monthly benefit of $5,000 at the time of claim. Assume CPI of 4%.

a) If the policy includes an increasing claim benefit, what is the benefit amount in the fourth year of claim?

b) If the policy does not have an increasing claim benefit, what is the benefit amount in the fourth year of claim?

Activity 5

Louisa’s insured income is $10,000 per month. This income has increased by $1,000 per month every year so after three years it now sits at $13,000 per month.

The initial monthly benefit applied for is assumed to be $7,500 per month as this is 75% of Louisa’s net income. This monthly benefit has increased in line with indexation, and after three years of applying a CPI increase of 3%, the insured amount is now $8,195. After three years, Louise makes a claim.

a) Under an agreed value policy, what is the maximum benefit payable for total disability?
b) Under an indemnity value policy, what is the maximum benefit payable for total disability?


c) Under an agreed value policy, what is the partial benefit payable, assuming Louisa is returning to work on a part-time basis and earning $5,000 per month?


d) Under an indemnity value policy, what is the partial benefit payable, assuming Louisa is returning to work on a part-time basis and earning $5,000 per month?


e) If Louisa’s income had not increased beyond $10,000 per month, what is the maximum total disability benefit payable under an indemnity policy?
Activity 6

Michael is a self-employed consultant and as such has no sick leave or group salary provisions. His ongoing expenses are quite significant, which means he relies heavily on his income as a consultant. He has approximately $12,000 in his bank account and around $20,000 available as a redraw facility in his home loan.

Consider two alternate recommendations for Michael based on:

- Providing cover for him as soon as practical
- Providing cover which allows for his available funds to be used

Activity 7

John owns a consulting business. His income is derived through consulting fees he generates himself, as well as fees from his senior consultant. He has one other staff member who looks after the administrative side of the business. John would like to insure his business expenses so he is not “too much out of pocket” if he were disabled for a period of time.

The fees generated by his senior consultant are $240,000 p.a. and he pays her $90,000 p.a., he pays himself a salary of $125,000 p.a. and his assistant’s salary is $65,000 per year. The office lease and other ongoing expenses amount to $4,600 per month. Develop a monthly business expenses sum insured to recommend to John.
Activity Answers

Note:
Students’ responses to the activity exercises will vary according to economic conditions prevailing at the time and may also be influenced by their personal circumstances. The following notes seek to provide general guidelines only.

Activity 1
Define the following terms:
- Life insured
- Bundled
- Qualifying period
- Interim cover
- Level premium
- Future insurability

Go onto the internet and look at some different product providers to see if they define any of the above terms differently.

Response
- Life insured—person whose death or disablement gives rise to a claim.
- Bundled—policy that has an insurance and investment element. It does not direct a specific allocation of the premium payment towards the cost of the insurance cover, the investment or the administration fees.
- Qualifying period—the period that must expire prior to certain benefits becoming payable.
- Interim cover—cover offered while the application is being assessed. Usually covers accidents and is limited to a set number of days.
- Level premium—where the premium amount is the same over the life of the policy, irrespective that the risk incurred increases as the life insured ages. A level premium may be more expensive at the beginning of the policy than a stepped premium, but will be cheaper as the life insured ages.
- Future insurability—allowance for future increases in cover for certain defined events, such as marriage or birth of a new child, with limited further application requirements.
Activity 2
Define the following TPD policy wordings:

Response

<table>
<thead>
<tr>
<th>Wording</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any occupation</td>
<td>Unable to ever perform any occupation that the insured is reasonably suited to, based on education, training or experience.</td>
</tr>
<tr>
<td>Own occupation</td>
<td>Unable to ever perform one or more tasks of their own occupation.</td>
</tr>
<tr>
<td>Home duties</td>
<td>Unable to ever perform domestic duties.</td>
</tr>
<tr>
<td>Loss of limbs or sight</td>
<td>A benefit is payable based on the insured losing the use of their legs, arms or sight. A more stringent definition may require an actual loss where the limbs have been severed. This definition does not usually require a qualifying period to be served, with benefits payable immediately upon claim.</td>
</tr>
<tr>
<td>Unable to perform the activities of daily living</td>
<td>A benefit is payable based on the insured being unable to perform certain activities of daily living without assistance on a permanent basis. The activities are usually specified, and may include: mobility, continence, eating or drinking, dressing and bathing.</td>
</tr>
<tr>
<td>Cognitive impairment</td>
<td>A benefit is payable if the insured suffers significant cognitive impairment (an incapacity which requires constant supervision).</td>
</tr>
</tbody>
</table>

Activity 3
Explain the purpose of trauma insurance with reference to its introduction.

Response
The original motivation for the development of trauma insurance was that patients who underwent major surgery were often forced to return to work due to financial pressure before full recovery. Trauma insurance was introduced to provide options and financial security at this time. Trauma insurance pays a benefit if the insured suffers an illness or traumatic event as specified by the policy (for example, a heart attack or cancer). Trauma insurance provides cover on where other benefit types commonly do not. This is mainly due to the omission of
specific measures against work or physical incapacity for most policy conditions which is clearly different to the definitions for income protection and TPD cover.

**Activity 4**

A policy has a monthly benefit of $5,000 at the time of claim. Assume CPI of 4%.

a) If the policy includes an increasing claim benefit, what is the benefit amount in the fourth year of claim?

**Response**

The monthly benefit amount will be $5,624 after applying three CPI increases ($5,000 x 1.04 x 1.04 x 1.04)

b) If the policy does not have an increasing claim benefit, what is the benefit amount in the fourth year of claim?

**Response**

The monthly benefit amount will remain at $5,000.

**Activity 5**

Louisa’s insured income is $10,000 per month. This income has increased by $1,000 per month every year so after three years it now sits at $13,000 per month.

The initial monthly benefit applied for is assumed to be $7,500 per month as this is 75% of Louisa’s net income. This monthly benefit has increased in line with indexation, and after three years of applying a CPI increase of 3%, the insured amount is now $8,195. After three years, Louise makes a claim.

a) Under an agreed value policy, what is the maximum benefit payable for total disability?

**Response**

The total monthly benefit is $8,195, in line with the CPI increases.

b) Under an indemnity value policy, what is the maximum benefit payable for total disability?

**Response**

The monthly amount payable will be the lesser of the monthly benefit and 75% of the average pre-tax income in the twelve months prior to claim. The monthly benefit is $8,195, and the average monthly income just prior to claim
is $13,000 – 75% of which is $9,750. Therefore the benefit payable is $8,195.

c) Under an agreed value policy, what is the partial benefit payable, assuming Louisa is returning to work on a part-time basis and earning $5,000 per month?

Response
The total monthly benefit is $5,043 per month.

The formula to calculate the partial benefit is:

\[
\frac{(A - B) \times C}{A}
\]

where:

- \(A\) = pre-disability income
- \(B\) = post-disability income
- \(C\) = monthly benefit

\(A = 13,000, B = 5,000, C = 8,195\)

\[(13,000 - 5,000) \times 8,195 / 13,000 = 5,043.\]

d) Under an indemnity value policy, what is the partial benefit payable, assuming Louisa is returning to work on a part-time basis and earning $5,000 per month?

Response
The total monthly benefit is $5,043 per month.

The formula to calculate the partial benefit is:

\[
\frac{(A - B) \times C}{A}
\]

\[(13,000 - 5,000) \times 8,195 / 13,000 = 5,043.\]

For indemnity policies, the partial benefit is also limited such that the partial benefit payment cannot be greater than 75% of the income in the twelve months prior to claim.

The income just prior to claim is $13,000, 75% of this is $9,750.

Therefore the benefit payable is $5,043 per month.

e) If Louisa’s income had not increased beyond $10,000 per month, what is the maximum total disability benefit payable under an indemnity policy?
**Response**

The monthly amount payable is the lesser of the monthly benefit and 75% of the average pre-tax income in the twelve months prior to claim. The monthly benefit is $8,195, and the average monthly income just prior to claim is $10,000 – 75% of which is $7,500. Therefore, the benefit payable is limited to $7,500.

**Activity 6**

Michael is a self-employed consultant and as such has no sick leave or group salary provisions. His ongoing expenses are quite significant, which means he relies heavily on his income as a consultant. He has approximately $12,000 in his bank account and around $20,000 available as a redraw facility in his home loan.

Consider two alternate recommendations for Michael based on:

- Providing cover for him as soon as practical
- Providing cover which allows for his available funds to be used

**Response**

To provide cover for Michael as soon as practical, the recommendation would be an income protection policy with a 14-day waiting period, payable to age 65. A 30-day wait could be considered to reduce the premium.

To provide cover using his available funds, the recommendation would be an income protection policy with a three month (90-day) waiting period, payable to age 65. The longer waiting period is suggested as some funds are available to cover income shortfall in this period.

**Activity 7**

John owns a consulting business. His income is derived through consulting fees he generates himself, as well as fees from his senior consultant. He has one other staff member who looks after the administrative side of the business. John would like to insure his business expenses so he is not “too much out of pocket” if he were disabled for a period of time.

The fees generated by his senior consultant are $240,000 p.a. and he pays her $90,000 p.a., he pays himself a salary of $125,000 p.a. and his assistant’s salary is
$65,000 per year. The office lease and other ongoing expenses amount to $4,600 per month. Develop a monthly business expenses sum insured to recommend to John.

**Response**

The monthly sum insured would be calculated as follows:

- To cover non-income earning staff; $65,000 per annum or $5,416 per month
- To cover lease and other business expenses; $4,600 per month

A recommended business expenses policy with a benefit amount of $10,000 per month to cover the above expenses should be considered. John should consider a 30-day waiting period or shorter if this is affordable.
Review Questions

1. There are two types of traditional life insurance policies. Name them, and provide a brief description.

2. Explain the concept of convertibility for traditional policies.

3. What is a terminal illness benefit on a term life policy?

4. Examine the additional benefits on a term life policy listed below and state whether they are a standard inclusion or an optional extra (for extra premium cost).

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Standard or Optional?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children's trauma cover</td>
<td></td>
</tr>
<tr>
<td>Indexation benefit</td>
<td></td>
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<tr>
<td>Funeral expense advancement</td>
<td></td>
</tr>
<tr>
<td>Business future insurability</td>
<td></td>
</tr>
</tbody>
</table>

5. Is there a qualifying period for claims on a TPD policy?

6. What is the hour-based income protection definition?

7. What is the income-based income protection definition?

8. Peter and Mary are friends and partners and own a picture framing business. They work fulltime in the business as framers and employ one other full time picture framer. They employ one full time sales and business development manager, Miriam, and a part time administration assistant, Clare. The business rents the premises and has large supplies of plant and stock on site.
Classify which type of insurance structure they will need in the following circumstances:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Insurance structure</th>
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<tbody>
<tr>
<td>Peter suffers a serious car accident. His injuries are so severe it is</td>
<td></td>
</tr>
<tr>
<td>expected he will not be able to return to work.</td>
<td></td>
</tr>
<tr>
<td>While Peter is sick Miriam suffers a back injury and cannot work for</td>
<td></td>
</tr>
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<td>three months. Miriam is the key revenue generator for the business.</td>
<td></td>
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<tr>
<td>Tragically, Peter never recovers from his injuries and dies nine months</td>
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9. Explain the continuation option for members of a group insurance policy. Why are they of value to the life insured?
Review Answers

1. There are two types of traditional life insurance policies. Name them, and provide a brief description.

Response
- Endowment insurance—policies which have a fixed term maturity date (such as 10, 15 or 20 years or are set to mature at a specific age such as 18 or 21, as was commonly the case with child endowment or policies).
- Whole of life insurance—policies which have a premium ceasing date greater than age 65 and commonly to 85 years – with cover generally continuing to a later point, such as age 95.

2. Explain the concept of convertibility for traditional policies.

Response
Whole of life policies may be converted to an endowment policy, which has the effect of lowering the sum insured, but increasing the growth of the savings element until the future expiry. Conversions can only take place after a minimum period of time, such as 10 years in force, and the new expiry date must be set with a minimum number of years, for example five years. In a similar way, endowment policies can generally be converted to an earlier expiry date than originally set. This reduces the value of the sum insured, but increases the level of savings than would have otherwise accrued over the same period.

3. What is a terminal illness benefit on a term life policy?

Response
Terminal illness cover is an advancement of the death benefit (that is, it reduces the life cover by the amount of benefit paid) when the insured is diagnosed with a condition that is incurable and likely to result in death within a defined period of time (usually 12 months). Payment is dependent upon confirmation of terminal illness by at least one medical specialist. The maximum amount paid is usually capped at $2 million. If the sum insured is higher than $2 million, then the balance is paid upon death.

4. Examine the additional benefits on a term life policy listed below and state whether they are a standard inclusion or an optional extra (for extra premium cost).
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5. Is there a qualifying period for claims on a TPD policy?

Response
Yes, once the insured becomes disabled there is usually a three or six month period to qualify for a benefit, during which the insured must be continuously unable to work (this applies to the occupational definitions). If the benefit is for one of the non-occupational TPD definitions, such as loss of limbs or sight, then the insured may be eligible for an immediate payment.

6. What is the hour-based income protection definition?

Response
The hours based income definition generally refers to the inability to perform an “important duty” for a set number of hours per week, (such as ten hours) to qualify for a benefit. A sample policy wording would be: “you are unable to perform the important income producing duties of your usual occupation for more than 10 hours per week, and you are not working more than 10 hours per week in any occupation”

7. What is the income-based income protection definition?

Response
An income-based definition requires the insured to be unable to generate a certain level of income, (such as 80 percent of pre-disability income) to qualify for a benefit. A sample policy wording would be, “Until the expiry of the waiting period you are unable to generate at least 80 percent of your pre-disability earnings from personal exertion in your usual occupation”.

8. Peter and Mary are friends and partners and own a picture framing business. They work fulltime in the business as framers and employ one other full time picture framer. They employ one full time sales and business
development manager, Miriam, and a part time administration assistant, Clare. The business rents the premises and has large supplies of plant and stock on site. Classify which type of insurance structure they will need in the following circumstances:

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<td>Tragically, Peter never recovers from his injuries and dies nine months</td>
<td>Peter and Mary should have detailed a business succession plan if such an event were to occur. This should include a buy/sell agreement.</td>
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9. Explain the continuation option for members of a group insurance policy. Why are they of value to the life insured?

**Response**

Upon leaving an employer where a group insurance plan was in place, a continuation option may apply. Continuation options simplify the process of continuing the cover that has been lost as a result of ceasing employment. The continued cover may only be issued on similar terms and for a policy with similar cover as the group policy. Continuation options are of value because they simplify the process of maintaining cover (little or no underwriting is required), and they minimise the chance that cover will not be available to the insured (if underwriting was required, any health issues of the insured may preclude them from obtaining cover).