Mortgage Protection

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For most people the greatest expense in their life will be the purchase of their family home. Few of us will have the good fortune to complete this purchase without the assistance of a mortgage.

As part of their lending terms and conditions, all banks will insist on a life policy in the name of the borrowers, that at least covers the outstanding balance of the mortgage for the entire term of the mortgage. The proceeds of the policy must be assigned to the bank before any funds are released to the borrowers. The importance of maintaining this policy cannot be overstated. Should a borrower die before the end of the mortgage term, the bank could seek immediate repayment of the outstanding balance. Without the benefit of a life assurance policy, this demand would be close to impossible to meet for most people.

The cheapest form of life cover was created to meet the mortgage protection requirement. The sum assured reduces each month broadly in line with the outstanding mortgage balance. This type of policy is also known as decreasing term assurance. Typically, an interest rate of 6% is assumed by the life company and the sum assured reduces each year, allowing for this "interest amount", until it is at close to zero at the end of the mortgage term. In the current low interest rate climate, a 6% interest rate should ensure that the life policy sum assured will always be in excess of the outstanding mortgage amount.

Cover is typically arranged on a "joint life first death" basis for joint mortgages. In other words, if one borrower dies during the mortgage term, the sum assured applicable on the date of death is paid out and all cover ceases for the survivor. It is worth noting that from the proceeds of the policy, the bank is only entitled to the amount outstanding to them. Any surplus after the mortgage has been discharged will either form part of the deceased's estate or be paid to the surviving borrower.

It is advisable to consider including a conversion option on the policy. This provides borrowers with greater flexibility during the term. In the event you suffer a deterioration in health, this option would allow the policy convert from a decreasing term assurance to a level term assurance without the need to provide any further evidence of good health. In other words, the premium charged for amending the policy would be based on your age, the sum assured that applied on the date of the conversion and the intended term of cover for the new policy.

It is important to remember that if the sum assured on the original policy is reducing each year, the sum assured at the date of conversion could be substantially less than the initial amount.

Some people would like to have the peace of mind of knowing that in the event they suffer a serious illness, such as cancer or heart attack, their outstanding mortgage is cleared.
In fact, because of advances in medicine, you are statistically more likely to survive a serious illness than die from it. Therefore, the price of including specified illness cover in your mortgage protection is significantly dearer than the simple life policy and the cost may influence whether you cover the entire mortgage balance or a just a portion of it. If you have just part protected your mortgage in this way, it is important to remember that as the bank is considered the owner of the policy, you will not receive the proceeds of a specified illness claim if attached to the mortgage protection policy. Having a specified illness policy separate to your mortgage protection policy gives you the freedom to decide, in the event of a claim, whether to pay off some, none, or all of your outstanding mortgage balance.

Our advisors will be happy to talk about the various options available to you and the costs involved to help you make an informed decision.