

By Michael Berton



TOOLBOX

SITUATION CRITICAL

More Canadians are overcoming diseases and illnesses that were fatal 20 years ago. Critical illness insurance can come to the financial rescue.

Dr. Steve Kilmer (not his real name) thought he was adequately insured, until he was diagnosed with cancer. A successful dentist, he relied on his financial planner to advise him about covering his risks. He and his planner believed he was well insured between his personal life and disability insurance and business overhead insurance. Now at 55, he was facing one of the most frightening experiences in his life and he wasn't sure his insurance coverage would serve his most pressing need.

Steve wanted to begin the recommended radiation therapy immediately, but in his provincial medical system he was going to have to wait in a queue. His doctor told him that he could get the treatment without a wait if he were prepared to travel to the Mayo Clinic in Rochester, New York. But that decision came with a cost. Where would he find the money? Indeed, it seemed that although he was paying for all kinds of insurance, his current needs had somehow "fallen through the cracks." To get the medical attention he wanted, Steve would have to dig deeply into his retirement savings.

Steve decided to travel to the Mayo Clinic for radiation therapy. For six weeks he went to daily treatments. This resulted in a medical tab of CDN\$50,106, plus an additional



\$21,296 in expenses for food and lodging. He returned home with instructions to stay off work for another four months. At this point, he had already missed nine weeks from his busy dental practice. To maintain his business, he had to hire a locum to replace him at a cost of \$3,500 per week. As this is more than the practice normally can afford, he cannot draw any income for some time.

Steve will incur more than \$200,000 in expenses over his six months off work. Fortunately his disability and business overhead coverage will help. Under the terms of these contracts (see "Surplus or Shortfall?" on page 12), Steve can expect to begin receiving a monthly tax-free income of \$6,400 by

the end of the third month as well as up to \$10,000 in office cost reimbursements by the end of the second month. The initial three months of his cash flow and business operating expenses are a very real problem, and he will have to withdraw funds from his long-term savings. As these are registered, the cost of redeeming these assets is close to double after tax.

A simple \$150,000 critical illness (CI) policy would have served Steve well in this emergency. The payment would have covered all of his immediate costs, and would have taken a great deal of pressure off his disability income at the same time. Barring any other complications, Steve would end

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up with a surplus of \$73,067. Rather than raiding his long-term savings to fund his medical costs, Steve could actually contribute to his savings, protect himself in the event of a relapse, reduce his re-entry workload for a short time or reduce some non-deductible debts.

Although much has been said and written about the virtues of critical illness insurance in recent years, many advisors continue to overlook or ignore this essential planning tool to the peril of both their clients and their own practice.

Odds are that your clients have a

better chance of suffering a catastrophic health issue than death. Canada Life statistics indicate that one in four Canadians will contract some form of heart disease, one in three Canadians will develop life-threatening cancer, more than 50,000 Canadians will suffer a stroke annually and a similar number will have multiple sclerosis. Interestingly, recent claims figures from five insurers quoted in *Insurance Journal* (September 2001) show that a majority of claimants are between the ages of 36 and 50; 62.6% are male. An unexpected critical illness represents the most likely risk to your client's

financial plan.

Most advisors have been trained to evaluate the appropriate amount of life and disability insurance coverage for their clients. While CI has elements of both of these, it functions quite differently. As a result, the determination of appropriate coverage for a critical illness is difficult to estimate and many advisors are uncertain as to the level of insurance they should recommend. "The amount of coverage has to be based on your client's current financial situation and expectations for recovery," says Scott Furr, a registered health underwriter

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SURPLUS OR SHORTFALL?							
A critical illness policy can eliminate all of the client's out-of-pocket expenses.							
Cash Flow Summary: Dr. Steve Kilmer Annual Income \$150,000							
	July	August	September	October	November	December	Total
Hospital bill	\$33,404	\$16,702					\$50,106
Food and lodging	\$14,197	\$7,099					\$21,296
Travel expenses	\$500	\$500					\$1,000
Home care and assistance		\$500	\$1,000	\$1,000	\$1,000	\$1,000	\$4,500
Lost earnings (net)	\$6,538	\$6,538	\$6,538	\$6,538	\$6,538	\$6,538	\$39,231
Quarterly tax installments			\$12,000			\$4,000	\$16,000
Normal bus o/h expenses	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$60,000
Additional bus o/h due to locum	\$1,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$11,000
Total Expenses	\$65,640	\$43,339	\$31,538	\$19,538	\$19,538	\$23,538	\$203,133
Net Bus Income (available to cover o/h)	\$7,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$57,000
Disability Insurance (maximum benefit)				\$6,400	\$6,400	\$6,400	\$19,200
Business Overhead Insurance		\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$50,000
Net Monthly Shortfall (+=surplus)	-\$58,640	-\$23,339	-\$11,538	\$6,862	\$6,862	\$2,862	-\$76,933
							If critical illness insurance policy had been purchased
							\$150,000
*CI Policies pay their entire face benefit 30 days after diagnosis for most covered illnesses.							\$73,067

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living benefits marketing consultant at PPI Financial Group in Vancouver. "You must consider the costs of the initial medical impact, the ongoing financial impact, and lifestyle costs the client may wish to cover."

Possibly the best way to estimate coverage is to construct an emergency cash flow scenario to see what would be required in that client's individual situation. There are several areas to consider.

Initial Medical Expenses:

- › access readily available and expensive healthcare in the United States or elsewhere
- › alternative sources of healthcare not covered by traditional plans
- › medical expenses that are either not covered or are only co-insured by your existing plans
- › special appliances, equipment or conversions/renovations to accommodate your new medical status (wheelchair access, elevators, moving expenses, etc.)

Ongoing Special Expenses:

- › immediate debt elimination
- › immediate loss of income before long-term disability benefits start
- › ongoing loss of income during the recovery period (3 to 12 months)
- › key person replacement in business
- › additional childcare or housekeeper costs if needed

Post-illness Lifestyle

Change Expenses:

- › restructure a business so that you can work fewer hours and/or travel less
- › afford to take more leisure time
- › career change or retraining
- › home or business relocation

Critical illness insurance should not be viewed as an alternative to disability insurance, but as a complement. While disability insurance premiums have increased in recent years, CI premiums have remained fixed as the insurers gather their Canadian claims data. These policies offer a range of premium options from 10-year term to level-term to 65, 75 and 100. "Don't discount term-style pricing on CI products due to your life insurance training," says Keith Leech, a Vancouver-based registered health underwriter and consultant with HUB International. "If you can protect your clients for one or two renewals, you will statistically deliver cheques to many of them. Further, with the right advisor managing their investments, they will hopefully be better financially prepared to deal with a critical illness in 10 or 20 years."

Return of premium riders have long been offered on disability products as an incentive for policy owners. The addition of such riders on death or surrender of critical illness policies makes the buying decision more palatable to many clients. The CI premium riders are very inexpensive compared with those on disability insurance. Some insurance marketers have promoted the idea that such an option could be considered as a tax-free investment. Advisors should be aware that this has recently caught the attention of the CCRA and the tax status of CI benefits and return of premiums is now being questioned.

As in Steve's case, a critical illness policy can go a long way to take the pressure off the income expected from a disability insurance policy. Clients with large mortgages or other major debt responsibilities could cover them

with the critical illness policy, then select a lower income benefit in their disability coverage. In some cases, CI can reduce the need for a short elimination period. For example, a 55-year-old male could buy a \$4,800 policy with a 91-day elimination period as well as a \$100,000 term to age 65 critical illness policy for less than just a \$4,800 disability policy with a 31-day wait. On an annual basis the 31-day policy would cost \$6,669.93 while the 91-day policy + CI policy combination would cost only \$6,054.49, a saving of \$615.44. You should be aware, however, that it may be difficult for a client to get a preliminary diagnosis from a physician, then be referred to, seen and diagnosed by a specialist and have the critical illness claim completed within the first 30 days. Be careful how you position this promise. Although a critical illness claim can be paid out as early as the 31st day, it can take a few months to process the claim.

If your client suffers a critical illness and can take advantage of insurance coverage that you have recommended, you will be considered not only a hero, but you will have demonstrated the very real value of your advice and comprehensive financial planning. You will also have maintained the client's goodwill and the assets you have the privilege of managing. Anything less might send away a valued client and could potentially be grounds for a lawsuit. **AE**

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