BY ANDRÉ L'ESPÉRANCE

Plan for the worst-case scenario

Critical illness insurance can be instrumental to comfortable retirement

While there are many issues to deal with when someone is diagnosed with a critical illness, one that's often overlooked is the financial burden it can place on family and loved ones.


L'ESPÉRANCE

Despite our progressive health-care system, we still are faced with increased waiting periods and out-of-pocket expenses for medication, medical equipment and treatments that are not covered by the public health system.

With this in mind, clients should ask themselves the following three questions:

1. Do you know anyone who in the last few years has suffered from cancer, heart disease or a life-altering illness?
2. Did that event have an impact on their lifestyle or finances?
3. Would a lump sum benefit have helped?

Critical illness insurance (CII), unlike any other living benefit, is not related to earned income and does not pay out a monthly benefit for a specified period. CII is a lump-sum benefit triggered by a life-altering illness (as defined by the insurance carrier).

The benefit is paid after a specific waiting period (30 days in most cases). Another important element is that there are no restrictions on the use of the benefit. Common uses include:

› Out-of-country treatment
› Alternative treatments
› Medications not covered by public health system
› Vacations
› Home or vehicle alterations
› Debt repayment
› Home care

Statistics

The most common reaction to CII is, "I don't need it, I'm healthy!" But statistics tell us we are far more likely to suffer from a critical illness before age 75 than die from one. In fact, in Canada the probability of surviving a critical illness before 65 is twice as great as dying from it. What used to be considered a terminal illness is now often survivable.

Coverage

Covered illnesses may vary by insurance company. However, most contracts cover illnesses such as cancer, heart attack and stroke. Other illnesses and life-altering events covered can include: multiple sclerosis, paralysis, Parkinson's disease, blindness, as well as many others.

Coverage can be purchased in a number of ways. The most popular choices are renewable term or level premiums to age 75. Renewable CII is an affordable way to provide coverage for a temporary need (e.g. to pay off a mortgage).

Level premiums to age 75 offer more permanent coverage that ensures the payment of equal premiums through the life of the contract. For affluent individuals, the use of permanent insurance could be the best choice, depending on their situation.

An additional feature that can be purchased and included in a plan allows for the return of premiums after a predetermined number of years or at death. While this feature may look expensive, consider that under certain conditions, you could get a full refund on premiums paid.

Case study

Martin is a vice president of a mid-sized software company. He is 42 years old and has a spouse and two children, one of whom is still in school. He has adequate life insurance but is fearful that a critical illness may derail his retirement plan.

During his last meeting with his advisor, Martin agreed such coverage was important, though he was concerned the premium costs would divert savings away from his retirement. Let's take a look at how it would impact his savings plan.

Current savings plan:

Non-Registered:	$500,000
Current Savings:	$24,000 per year
Net growth rate:	1.5%*
Projected value @ age 65:	$1,426,370

**The rate of return used is equal to the return of a fixed-income portfolio (3%) after tax (48% – Quebec tax rate table, 2011).*

Scenario 1
Purchase of CII (no illness)

If Martin redirects $7,748 per year from his current savings to the purchase of CII, does not suffer from an illness in the next 15 years, is reimbursed all the premiums by the insurer and terminates his CII, the result would be as follows:

› CII premium: $7,448 per year
› Contributions to savings plan: $16,252 per year ($24,000 minus $7,448)
› Projected value @ age 65: $1,408,506 (a reduction of $17,864 compared to the current savings plan)

**$7,748 is the annual premium for 15 years, which includes the return of premium riders at death or while living.*

Scenario 2
Suffer a critical illness at age 47 (without CII)

Suppose Martin suffers a critical illness at age 47, with an estimated cost of treatment and recovery of $250,000. Without critical illness coverage, his revised asset value at age 65 would be $1,091,263 — a reduction of $335,107 compared to the current savings plan.

Scenario 3
Suffer a critical illness at age 47 (with CII)

If Martin were to suffer a critical illness at age 47 and had CII, his cost of treatment ($250,000) would be covered by the policy benefit. His revised asset value would be $1,495,109 — an increase of $403,846 compared to scenario 2.

The benefits of CII

Critical illness insurance allows the policyholder to better manage risk. It targets individuals who wish to receive a lump-sum payment. Should there be a claim in the early years of the policy, this coverage will have an important impact on the insured's financial situation. Alternatively, the return of premium rider will minimize the economic impact associated with the payment of premiums.

For conservative investors who hold non-registered assets, the opportunity cost to move funds from a fixed-income investment to a critical illness policy is minimal (total of $17,864 for 15 years) as interest rates on this type of investment are at a historically low level and interest income is subject to the maximum tax rate. AER

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SUMMARY OF SCENARIOS

Situation	Assets at age 65
Without illness	
Current Savings Plan:	$1,426,370
Purchase CII:	$1,408,506 with return of premium in the 15th year and ending of contract
With illness	
Current Savings Plan:	$1,091,263
Purchase CII (with benefit):	$1,495,109

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