Understanding Critical Illness Insurance For Doctors

Rino Racanelli

"You need financial independence when you're ill. Not because you're going to die, but because you're going to live," Dr. Marius Barnard, world renowned heart surgeon who helped develop critical illness insurance.

Since its introduction to Canada in 1996, critical illness insurance continues to be one of the fastest growing sectors of the insurance market. This is because of the increased rate of life-threatening illnesses such as heart attack, stroke, and cancer. Critical illness insurance was designed to cover financial and medical costs associated with these life-altering illnesses. It not only replaces lost income, it also allows people to focus on what matters most: getting better.

How it Works

Unlike disability insurance, which pays you a monthly benefit based on your inability to work, critical illness insurance pays you a lump sum benefit if diagnosed with one of a number of covered conditions. After the diagnosis you must satisfy a 30-day survival period. Once the benefit is paid, you decide where the money goes.

There are several Canadian insurance companies that offer critical illness insurance. These companies compete in a bid to offer their customers the best protection at an affordable rate. Some of the top insurance companies will cover up to 25 conditions. Covered conditions can include: heart attack, stroke, life-threatening cancer, kidney failure, severe burns, aplastic anaemia, loss of speech, Alzheimer's disease, loss of limbs, bacterial meningitis, major organ transplant, benign brain tumour, motor neuron disease, blindness, multiple sclerosis, coma, occupational HIV infection, coronary artery bypass, paralysis, deafness, Parkinson's disease, heart valve replacement, aortic surgery and loss of independence existence. Each insurer has its own definitions and exclusions of these covered conditions and understanding the definitions and exclusions is of paramount importance.

Ontario Medical Association Plan

If you're a physician and a member of the Ontario Medical Association (OMA), then you'll be able to purchase the OMA group critical illness plan. Recently, I sat down with a client who did just that but had some reservations and concerns that the plan did not meet his needs. After a quick review, it was easy to see why. The plan was a 5-year term product, which means the insurance premiums would increase every 5 years. The plan was not permanent (for life) and expired at age 70. There were no extra benefits available (i.e. your money back if no claim is made.) His biggest concern was the amount of critical illness insurance that could be purchased was capped at $250,000, which was not nearly enough for any professional, especially a doctor.

Personally-Owned Or Owned By Your Medical Professional Corporation

Critical illness insurance can be purchased on an individual basis either personally or through your corporation. For a personally-owned plan, you simply pay the insurance premiums with after-tax dollars. If a claim is made, you will be paid the lump sum benefit tax-free.

Using the corporate-owned method, you purchase critical illness insurance through your Medical Professional Corporation (MPC.) If you use your MPC to pay for the plan, then your MPC will also own the plan. There are several advantages to purchasing the plan this way. First and foremost is the ability to use lower after-tax corporate dollars to pay the insurance premiums. You don't have to take money out of your MPC; you simply move that money from your corporate savings account to pay for the insurance plan. The money never leaves the corporation and no taxable dividend needs to be paid out. Secondly, by moving money out of your MPC you pay less corporate tax on the money that remains invested in the corporation thus reducing your current tax exposure.

If there is a claim, your MPC will receive the lump sum payment tax-free. Once in the corporation the shareholder would decide the most effective way to receive the payment: by taxable dividend, salary or bonus, or repayment of an outstanding shareholder loan or repayment of paid-up capital. There is no obligation to distribute the full lump sum amount in a taxable dividend in one year. The amount could be distributed over a period of time when needed.

How Is It Priced?

Because your chances of getting a serious illness and surviving are greater than your chances of dying, critical illness insurance costs more than a traditional life insurance policy. Premiums are computed according to gender, age, smoking status, and a thorough evaluation of your health, lifestyle, and family health history. Along with the above criteria, other factors that influence the cost of insurance include the type of product and the amount of coverage purchased, with term insurance being the least expensive and permanent insurance the most expensive. Most companies will accept an application starting at $10,000 up to a maximum of $2.5 million. The more coverage you want, the more it costs.

Critical Illness And Return Of Premiums

A popular product today for doctors, dentists, and other professional high-income earners is a paid-up permanent critical illness plan. The insurance is for life and is guaranteed to be paid-up after a number of years. Once paid-up, there is an option to cancel the plan and get all your money back if no claim is made. Or, you make no more payments and have the insurance for the rest of your life.

Let's look at an example showing real numbers:

Dr. Barbara Chan, a 50-year-old physician, incorporated her medical practice back in 2006. During the past ten years, she's been generating a significant amount of excess cash flow every year and retains a considerable portion of business profits within her corporation. These profits are currently invested in Guaranteed Investment Certificates (GIC), dividend-paying stocks, bonds, preferred and common shares. Every year her company pays tax on the income generated from these corporate investments (interest 50.17%, capital gains 25.08% and dividends 38.33%). She is looking for ways to reduce her corporate tax payable, supplement her retirement income, and more importantly, protect her ability to earn an income if diagnosed with a life-threatening illness.

Using corporate dollars to pay the insurance premiums was an attractive opportunity for her. When deciding on how much money to transfer to the insurance plan, Dr. Chan took into consideration: How much money she earned that she was never going to spend (she would re-allocate those saved dollars and slowly move them into the insurance plan.) She did not want to sacrifice her current lifestyle in any way and still have enough money for a back-up fund.

With the help of her insurance advisor she decided to transfer approximately $80,000/year for 15 years from her corporate account to the insurance plan.

After shopping the insurance market for rates, she found a highly-rated Canadian insurer offering a $2 million permanent plan with an annual payment of $77,900 paid-up in 15 years. Once the plan was approved the insurance policy was issued.

After 15 years Dr. Chan had a couple of options:

a. Keep the plan, no more payments, and have the $2 million critical illness insurance for life.

b. Cancel the plan and get all her money back. She would be paid a total of $1,168,500 tax-free ($77,900 x 15 years) at age 65. This amount could be used to supplement her retirement income if she chose to do so.

In Conclusion

Critical illness insurance was created to help protect your greatest asset—your ability to earn an income. Each company has its own policy features, benefits, covered conditions, definitions and exclusions and understanding the definitions and exclusions is important. The cost for the insurance varies between companies and shopping around for the best product and price makes sense.

Rino Racanelli is an independent insurance advisor in Toronto, ON. racanelli@sympatico.ca www.CoroprateTaxShelter.ca