Contingency Risk

Contingency risk is the risk that a life-altering medical event could trigger a serious financial setback.

Exceptional physical achievements by those who desire the most out of life are less constrained by age than ever before. Consider Sir Ranulph Fiennes, 59, and Dr. Michael Stroud, 48, who, in October 2003, ran seven marathons on seven continents in seven days. This extraordinary accomplishment was doubly amazing because four months earlier, Sir Ranulph had undergone double bypass heart surgery as a result of a severe heart attack. His recovery from a critical illness is not only remarkable, it exemplifies true inspirational defiance of limitations.

Advances in medical science, coupled with the trend toward a healthy lifestyle, have resulted in increased longevity and longer periods of health and wellness. Hence, most of us can look forward to a longer period to enjoy post-career activities. A recent survey found that 82 per cent of Canadian Baby Boomers plan to do "some" or "a lot" of physical recreational activities in their later years, while only 64 per cent of those currently in retirement report doing the same[1].

We do, however, need to plan for the possibility that recovery from a critical illness could take longer than the few months it took Sir Ranulph. In fact, it could take a few years. According to the World Health Organization (WHO), as a population we should expect to experience an extended period of ill health at some stage of our later life.

The WHO measures "healthy" life expectancy as opposed to the traditional model of life expectancy. For example, a 60-year-old Canadian female with a life expectancy of 82 years, can expect to have an additional 19 years of good health[2] (i.e., a "healthy" life expectancy of 79). On the plus side, we can look forward to almost two more decades of healthy living. It's the potential three years of impaired health that is cause for concern, particularly when one considers the unexpected funding of medical costs.

Public health care programs are limited, with increasing support for user-funded medical services. In addition, the Boomer generation will put enormous strain on governmentfunded programs. The inevitable result will be the downloading of health care costs to the individual. Using accumulated assets to fund unexpected medical expenses could derail one's financial, retirement and estate plans.

So, how do we tackle the unanticipated costs associated with aging? A sound financial plan includes a contingency plan to mitigate the financial burden that results from a critical illness, the need for long-term care or premature death.

Strategies to Fund the Unexpected

There are a number of strategies to build a financial buffer to protect your accumulated wealth. The suitability of one strategy over the other depends on your unique requirements and resources. An important first step is to meet with your financial advisor to explore "what if" scenarios related to allocating

[1] *Investor's Group Survey – January 2005*

[2] *World Health Organization, 2005*

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a portion of your portfolio to health care expenses. For example, if you withdrew $100,000 from your portfolio to fund out-of-country medical expenses, what impact would that have on your retirement plan? Could you still realize your financial goals? Once you've identified the potential impact of unforeseen events on your finances, the next step is to consider strategies to mitigate the risk. How?

1. Increase your savings and earmark that money as your contingency fund.
2. Explore "living benefits" protection.
3. Create a contingency fund for your surviving spouse.

Increase Your Savings

Increasing your savings is likely the simplest strategy. If you have surplus income or redundant assets, redirect them towards a "health care expense account."

Funding Medical Recovery

Today we survive many illnesses that, in the past, would have resulted in death. However, while "we" are surviving longer, our finances are not. Medical expenses tend to increase during the period of recovery, while employment income decreases or disappears. Treatment outside of Canada can be very costly and one may need to assume new expenses such as modifications to the home, debt repayment or help with domestic activities. Critical illness insurance provides money to help pay for expenses beyond those covered by government or employer health plans. A tax-free lump sum benefit equal to the amount of insurance purchased is paid to the insured upon medical diagnosis of a critical illness. The majority of critical illnesses are covered by leading insurance companies. How you use the money is entirely up to you—paying off your mortgage, renovating your home or car to accommodate new special needs, paying for specialized treatments, or injecting money into your business to keep it going while you recover.

Case Study: Catherine

At the age of 44 Catherine contracted a rare form of cancer called Amyloidosis—a plasma cell tumor diagnosed by the Mayo Clinic in Rochester, N.Y. The prognosis was grim, calling for a painful treatment and a stem cell transplant with a low survival rate. Catherine opted for treatment at the Mayo Clinic; however, the cost was prohibitive at $300,000 US. She and her husband decided to seek treatment at a clinic in Canada that had done over 200 stem cell transplants. Some of the treatment costs and a few of the medications were covered. Furthermore, the treatments took Catherine and her husband away from home for three months. At the time their children were ages 15 and 8.

While reviewing her financial plan two years before being diagnosed, Catherine realized that if she or her husband were to suffer a serious illness, her family could encounter financial needs over and above what disability insurance would cover. She purchased two critical illness protection policies—one with permanent coverage and the other with temporary coverage—for $110,000.

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Catherine's foresight meant she was able to:

- hire a live-in helper to care for the children while her husband stayed with her throughout the treatment;
- seek additional medical opinions;
- settle outstanding bills; and
- focus on recovering.

Today, Catherine enjoys good health and is actively involved with her family, career and outside interests.

Long-term Care Protection

Baby Boomers are the sandwich generation, often providing for both children and parents concurrently. By 2010, 60 per cent of Canadians over the age of 50 will have a surviving parent. The cost of caring for parents can be significant. A Watson Wyatt study found that in the past five years, the number of employers providing retirees with health coverage dropped from 50 per cent to 31 per cent. That same study predicted that within 30 years 90 per cent of all our costs associated with long-term care—nursing expenses, drug costs, etc., will not be covered by existing plans.

The purpose of long-term care insurance is to fund the costs of either in-home or facility care. The annual cost of an assisted living facility (versus full nursing care) ranges from $36,000 to $70,000, depending on the location and type of facility. Home care is more common and more expensive in Canada, ranging from $18 to $38 per hour for a caregiver. With the average duration of care ranging from three years for facility care, to four and a half years at home, the bills can quickly add up. Long-term care insurance provides a daily benefit amount to help subsidize the costs.

Create a Contingency Fund for Your Surviving Spouse

A projection of assets and income for a surviving spouse should include a contingency fund for health-related costs—especially if your estate plan indicates that certain assets are not to be sold so they may pass down to the next generation. If there is concern that there will be insufficient funds available to support the surviving spouse, then life insurance may be a viable option. The advantage of life insurance is that it provides instant liquidity upon death of the insured and the proceeds are tax-free. We can't predict the future but we can create a financial plan to provide for the unexpected. Your financial advisor can help.

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