Johnson Schock Lowden Inc.

*Your Employee Benefits Partner*

# Critical Illness Insurance

Thousands of Canadians suffer from serious illnesses each year. Thanks to the advance of modern medicine and technology, many of these people will survive their ordeal. But recovery can be expensive and can take a long time.

Critical illness insurance helps survivors to manage the costs associated with recovery by providing a valuable lump-sum payment. This money, which can be used for any post-illness expense, helps critical illness survivors deal with the financial demands of recovery.

Having survived a critical illness, many people are unable to quickly return to work and are in need of ongoing medical attention or other care. Until recently, coverage for such needs wasn't available. While disability insurance provides income protection, it doesn't adequately provide financial assistance for expenses such as:

| ▪ Convalescence | ▪ Home Care |
|---|---|
| • Transportation | ▪ Pension Supplement |
| • Home Modification | ▪ Dependent Care |
| ▪ Supplementary Income | Medical Expenses (not covered by government or private health plans) |

## What is Critical Illness Insurance?

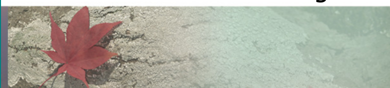
Critical Illness Insurance (CI) pays a tax-free lump sum benefit directly to you or your spouse (in the event of spousal coverage) if you are diagnosed with a major critical illness or injury and have survived for a period of 30 days (365 days in the event of paralysis). See below for a list of critical illnesses.

## How did Canadian employers get into retiree benefits?

Retiree benefit plans have generally evolved over time rather than being carefully designed for the long term. They were certainly not documented like pension plans. Often they were not communicated as well as active employee benefit plans. Many employers fell into them by default when the first employee to retire asked what benefits retirees would have in retirement. Employers who hadn't prepared a response to this in advance gave retirees an extension of the benefits they were receiving as active employees. Other employers agreed to provide retiree benefits through collective bargaining or from competitive pressures, real or imagined. Often it was assumed that the cost to provide the benefits would be minimal due to integration with government-sponsored programs and cash flow accounting.

## Where are retiree benefits now?

Now these employers may have hundreds or perhaps even thousands of retirees. They may expect to have more retirees than active employees in the near future. They may even have already reached this point. Benefit costs are increasing rapidly and government-sponsored plans are reducing the services and costs they cover.



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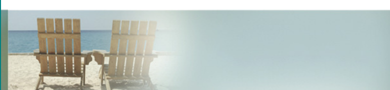

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With recent accounting changes forcing employers to assume a charge to their bottom line for the cost of retiree benefits, many employers are now seriously reconsidering their position on these benefits.

## Where are retiree benefits going?

For generations, most Canadian retirees have assumed that along with the pension plan would come health benefits that would take them through their retirement years. But what may have been standard practice in the past doesn't necessarily apply for Canadians heading toward retirement in the future.

The growing cost of retiree benefits has moved the issue to the forefront of the organizational agenda. Many employers, as our 2004 Quick Poll on Post-Retirement Benefits indicates, are focusing on changes to their existing retiree benefit plans in an attempt to manage their health care costs and their bottom lines.

The issue as to whether retiree benefits can be changed for current retirees has not been adequately resolved by the Canadian courts. Therefore, the changes to existing retiree benefit plans are often (but not exclusively) being considered for future retirees only, and in some cases only for future hires. Changes that are being considered for existing retirees generally involve increasing retiree premiums or deductibles. Most of the changes being considered are along the lines of adding caps/maximums to limit the employer's cost or the introduction of retiree premiums as the summary below shows. Some other employers who currently have retiree benefit plans and employers who are thinking about introducing plans are considering more dramatic plan design options.

## What lies ahead for employers?

Many new designs are being contemplated as some employers are repositioning themselves. Some employers are taking the position of providing benefits against major or "catastrophic" claims, while making available products or options for retirees to buy. Other employers are taking a more radical approach and simply offering funds in the form of a Health Care Spending Account to retirees. There are also other alternatives. These newer plan designs go a long way to provide the employer with ultimate control of the plan costs and the rate of growth of such costs.

As more responsibility for health care costs shifts to the retiree, the advantages for them to have a tax-effective vehicle for saving for their health care expenditures in retirement will become increasingly evident. To date, the Canadian government has shown little interest addressing this issue.

## Issues to consider in the future?

The primary issue for employers is to determine whether they want to provide retiree benefits and at what levels. Employers need to decide what parts of health care they want to be responsible for and what parts they want to help facilitate for a retiree and what part they do not want to be involved in. There are other considerations that employers need to address when looking at retiree benefits. For example, does the presence of (or the absence of) retiree benefits enable (or prevent) an employee from retiring? Should retiree benefits be related to service? And finally, what should be the responsibility of the retiree or government-sponsored programs?



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Employers who are exploring these questions are no longer reaching the conclusion that they should be the traditional first dollar payer of all health care services and be content to let the cost of their plans increase without an overall limit to the company.

We are in a period of transition as employers move toward a plan design that meets their HR and total compensation philosophy, as well as their retirees' needs. Those who can complete this journey while keeping their employees and retirees satisfied, and without causing undue burden on the company's financial statements, will have a significant competitive advantage over those who do not.

## Saving retiree benefits

With the spotlight on the high price of post-retirement benefits, employers are looking for quick fixes. Pre-funding is a remedy with merit.

What do changes in accounting rules, a supreme Court of Canada decision, government cutbacks and expensive new drugs have in common? All of these factors combined create real problems for employers and employees when it comes to non-pension, post-retirement benefits programs.

### Accounting Rules

Changes to accounting rules, which came into effect in Jan. 2000, require employers to include the full projected cost of post-retirement benefits--not just annual premiums--for current active employees, as well as retirees, on their financial statements.

This change has put public companies in a position where the full cost of these benefits and their impact on a company's bottom line have attracted the attention of board members, senior managers and analysts. As a result, cost containment or elimination of these expenses has become the central focus of discussions and concerns raised about retiree benefits.

Some might think that the easy solution to this problem is to simply eliminate or reduce retiree benefits. One of the problems with this approach, however, is that the decision of the Supreme Court of Canada's *CAWvs.Dayco* ruling in 1993 stands in the way of taking away retiree benefits.

In this case, the Supreme Court ruled that retiree benefits were vested benefits that could not be taken away from retirees. As a result, the benefits of the current retiree population cannot be eliminated or cutback unless the employer has reserved the right to amend its plans and has communicated this power to employees. The legal reality is that only in exceptional circumstances can benefits be taken away from retirees without their consent.

Government cutbacks in areas such as out-of-country medical and provincial drug coverage have made matters worse. Increasingly, the cost of drug benefits is shifting from the public sector to private plans. The advent of new drugs that are designed to treat the ills of aging baby boomers will only exacerbate the problem as governments are reluctant to pick up these costs.


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Employers have chosen to try and contain costs by reducing or eliminating post-retirement benefits for current, active employees and by curbing over-use. This type of solution works from a cost containment perspective because, over time, retiree benefits will be significantly reduced. But, over the long term, it actually results in a much larger issue.

## THE BETTER WAY

The baby boomers are aging, and they will be in need of post-retirement benefits. In the absence of government support and private plans, how will their needs be addressed? Fred Holmes, national practice leader, group health and welfare with Toronto-based Buck Consultants, thinks there is a better way to address the issue than reducing or eliminating benefits. He believes that the changes to accounting rules should be followed to their logical conclusion--pre-funding of post-retirement benefits.

"Setting up a group or individual non-pension benefits plan that accumulates assets on both a tax-deductible and a tax-deferred basis is the best way to go," says Holmes. "Treat it like a registered retirement savings plan or a pension plan and allow people to save for all of their benefits needs." This way, he believes, funds will be in place to satisfy all plan members' future needs.

The concept has merit. The issues that will inevitably arise as baby boomers age, and the crisis in post-retirement plans are problems that won't disappear on their own. Government sponsored pharmacare and homecare solutions may come eventually. But in the meantime, Ottawa should give Holmes's concept some consideration.

Hopefully, at minimum, this kind of practical thinking will ignite a much-needed debate on potential solutions to the post-retirement, non-pension benefits dilemma that is being faced by employers and aging baby boomers alike.