

# Critical Illness Insurance

"The biggest threat of all facing most small businesses is the death or serious illness of a partner or part owner of the business"

*Expert knowledge means success*

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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

## Introduction

Running a business today is tough. It's competitive and the advances in product and service design, use of technology and innovation mean that most business start-ups fail. Owners of small businesses face a number of risks - cashflow problems, recruiting and retaining key staff and keeping up with technology being among the main ones - but perhaps the biggest risk of all lies elsewhere. It's not competition, nor is it the advance of the Internet. It's something much closer to home.

The biggest threat of all facing most small businesses is the death or serious illness of a partner or part owner of the business. Businesses that rely heavily on their founders or owners could find themselves in real problems if these people die or become critically ill.

Research carried out by Swiss Life<sup>1</sup> identified that 96% of UK businesses are "small" (having less than 20 employees), yet few have insured against the risk of critical illness and in so doing are failing to protect one of their key assets - their employees. Just look at the risks (according to Scottish Provident):

- The chance of a healthy man aged between 20 and 40 dying before age 65 is 20%;
- The chance of becoming critically ill is higher at 25%;
- In a business with three directors in their 40s, the chance that one will die before reaching 65 is higher still - at 40%.

Whilst many business owners latch on to the risk of death and take out either permanent or temporary life insurance, the higher risk of critical illness is usually not insured at all - research shows that only 5% of UK businesses insure against this risk and only between 1% and 2% bother to insure key employees on the same basis.

The business owners who insure their lives do so usually so that, in the event of their death, funds will be available either for the business (as working capital) or to other partners or shareholders (providing the funds

to buy out the deceased business interest). An example of providing funds to buy out a business interest, on death or on critical illness, is given below.

### Example:

Arthur, Basil and Claude are in partnership together as ABC - the business is worth £750,000. Each of the partners takes out life insurance cover to provide £250,000 on death or on suffering a critical illness. At the same time, the partners enter into an agreement with each other (called a "cross-option agreement") so that:

- On death, the spouse or family of the deceased partner will sell and the remaining partners in the business will buy the deceased partner's business share for £250,000 with the funds provided by the insurance;
- If a partner suffers a critical illness, he has the right to sell and the remaining partners have the funds to buy that partner's business interest - enabling the partner who is ill to maintain a standard of living, to change his lifestyle or pay for medical treatment out of the funds received from the insurance policy.



## Even Superman didn't financially survive his critical illness without Insurance Cover

Most of us remember the tragic event that befell Superman Christopher Reeve after his unfortunate accident.

Sadly, his medical insurance ran out. Several treatments that might have helped him weren't covered by his health insurance. As a result, his hard-earned assets suffered a slow financial downward spiral. Apparently, it was Christopher Reeve's boyhood and life-long friend, fellow-actor Robin Williams, who paid the medical expenses that the "gaps" in health, life, and disability insurance left wide open.



### What is Critical Illness Insurance?

"Critical Illness Insurance - Pays out a lump sum on the diagnosis of certain life-threatening illnesses specified in the policy." *Association of British Insurers*

Critical Illness Insurance covers a policyholder against diagnosis of a critical illness such as cancer, heart attack, stroke or multiple sclerosis. It should be noted that medical "treatment" for such critical illnesses is usually covered by private medical insurance plans. A Critical Illness Benefit is an additional financial benefit, often a lump sum, paid on diagnosis of such critical illness.

Critical illness cover bridges the gap left by life insurance - which only pays out if you die.

## Insuring against Critical Illness

This publication is concerned with the need for people to insure against the risk of critical illness.

The statistics are clear: Today, people are living longer. And as they live longer, they're more likely to experience a heart attack, cancer, kidney failure, or other illness that can knock them down temporarily, but not necessarily out. Modern medicine knows how to keep people alive and functioning longer.

In your case, what will you be able to do if you become critically ill and are unable to work? That's more likely than dying before age 65, as the statistics we've already mentioned show.

Will the NHS help? Yes, to an extent, but don't count on it too much.

Will an ordinary life insurance provide the necessary funds to survive and pay for treatment? Sadly, the answer is No - life insurance policies are geared to paying out when people die, not when they fall ill.

The financial solution is to take out a Critical Illness insurance policy. This type of insurance is a modern type of policy. In "olden days", when life insurance was invented you were either alive and working or, if you became ill, you recovered and went back to work within days or weeks, or you died. It was as simple as that. Then, along came modern medicine with its powers to relieve pain and suffering and prolong life for months or, sometimes, years - ensuring survival, albeit with a lower quality of life. Today, people are surviving illnesses that in the past were fatal, but having survived, many people are unable to return to work or find that they have to pay for special medical care.



A Critical Illness policy provides a lump sum payment to the insured should that person be diagnosed as having one of a number of specified illnesses, conditions or diseases. Critical illness cover can be included in other types of policy and can also include an element of investment to provide a capital sum on death or maturity. Different life offices will pay out on the diagnosis of different conditions, though all cover heart attacks and most serious cancers.

The most common application of critical illness insurance is to cover a mortgage.

If you suffer a critical illness and receive a payout from the insurance company, the funds are yours to do with as you wish - for example, you can use the money:

- As income.
- To settle debts, or pay off a mortgage.
- To pay for private medical treatment.
- To change your lifestyle (such as modifying your home to accommodate your disability) or moving to a different environment.

This critical illness cover pays out following the diagnosis of a serious illness such as coronary heart disease, cancer, kidney failure, multiple sclerosis and major organ transplants.

The main options of Critical Illness insurance are *Term* (providing cover for a specified, limited term) and *Whole of Life* (providing cover throughout life). As you'd expect, the cost of limited cover under a Term policy is less than a Whole of Life policy. Sometimes, it pays to add life cover as well (to provide a payout on death).

Critical Illness Insurance cover is usually available to people between 18 and 65 years of age. Critical conditions covered can include those in the Table on the next page (covered conditions will vary - check with your own insurance company to see which apply).

### History of Critical Illness Insurance

Critical Illness Insurance was first introduced in 1983 in South Africa, where the man credited with the idea is Dr. Marius Barnard - the brother of Dr. Christian Barnard, the man credited with the first successful human heart transplant in the late 1960s. European companies began offering critical illness policies soon afterwards with North American companies introducing it on an increasing basis in the last few years.

## Conditions that might be covered (these vary between insurers)

Heart Surgery - Angioplasty, Bypass, Aorta or Heart Valve	Heart Attack
Cancer	Stroke
Kidney Failure	Liver Transplant
Pancreas Transplant	Lung Transplant
Bone Marrow Transplant	Paraplegia
Severance of Limb	Parkinson's disease
Loss of Sight, Hearing, Speech	Quadriplegia
Major Organ Transplant	Dementia and CJD
Motor Neurone Disease	Multiple Sclerosis
Alzheimer's Disease - including Pre-Senile	Severe Burns
Benign Brain Tumour	Loss of Independent Existence
Paralysis	AIDS / HIV via Blood Transfusion or following a Physical Assault
Coma	AIDS / HIV from Occupational Duties

## The Good News and the Bad News

People are five times more likely to develop a serious or life-threatening illness before the age of 65 than they are to die before retirement. But the plain fact is that nearly 600,000 people are diagnosed as suffering from cancer, stroke or heart attack each year.

Today, your chances of recovering from a critical illness, such as cancer or stroke, are better than ever. In fact, the good news is the probability of surviving a critical illness before age 65 is almost twice as great as dying.

What's the bad news? Surviving a critical illness can create new and unexpected financial hardships for you and your family.

## Policy features (features can vary by company):

- A lump sum payment is made 30 days after diagnosis with a covered condition or if you are involved in an accident that results in covered losses and you survive at least 30 days.
- Some policies offer a reduced benefit (usually 25%) if death occurs before the 30 day survival period.
- Policy amounts typically range from £10,000 to £500,000.
- Coverage terminates once a full benefit has been paid and/or you reach a specified age (usually 65).
- Many policies include a waiting period, typically 30 days from policy purchase date, before coverage begins.
- Pre-existing condition provision - policy will not cover any critical condition caused by, contributed by, or resulting from a pre-existing condition.

## Optional benefits often available for an additional premium (optional benefits can vary by company) can include:

- Extra coverage for additional types of cancer at a specified percent of the primary benefit amount (i.e., breast, ovarian and uterine cancer for women, and prostate and testicular cancer for men).
- Medical Consultation Benefit - provides medical consultation with a recognised authority on your covered illness. While not a common option yet, it could be a very desirable benefit if your current health insurance makes it difficult and/or expensive to see a specialist.
- Permanent and Total Disability benefit
- Dependent Children benefit
- Annual Health Screening benefit

## Critical illness insurance: How much does it cost?

The cost of critical illness coverage is usually based on your age, sex, whether you smoke, current health, pre-existing medical conditions, and the amount of coverage (benefit) chosen. Other things to consider include:

- Making sure you read the insurance company's standard definitions for the conditions covered in their policies. Check on what's left out or what isn't covered.
- Checking the insurance company's policy for a list of exclusions - for example, cancer, especially, is defined in different ways, and some companies distinguish between life-threatening and non life-threatening cancer. Even heart attacks are open to interpretation.
- Is there a short payout period? Most pay you 30 days after the onset of the illness.
- How is the lump sum paid? Make sure you get your money all at once, not by instalments.
- Riders. Can you also cover your children or spouse? What, if any, are the extra costs in doing so?

As with private medical insurance, the older you are, the more expensive your premiums will be. Your current state of health also affects premiums, especially if you are a smoker or have a specific health problem.

Sometimes, it may be necessary for you to complete a detailed questionnaire in order for the insurance company to "rate" the risk of insuring you. If you are over a certain age,

## Factors to consider for Critical Illness Insurance

- Premium, and whether stand alone or an add-on feature;
- Range and definition of allowable illnesses
- Whether a maximum cover limit applies.

and you may have to have a medical examination before the cost of insurance is determined. In general, critical illness insurance tends to be cheaper for women because they are less prone to cancer and circulatory diseases than men are.

Although there are companies advertising critical illness cover from as little as £8 per month as a rough guide, depending on existing life condition, the term of the policy and whether the policyholder smokes or not, premiums for £100,000 cover for a man aged 35 range from £40 to £80 a month, and for a woman from £40 to £70. The cost can come down if you add critical illness cover to a straightforward life insurance policy. A common ceiling for benefits set by insurers is a total pay out of £500,000.

## Insuring your employees - Group Critical Illness Insurance

A good benefits package can prove highly effective in attracting - and keeping - high quality staff. A good company pension scheme, private medical benefits and extra life insurance all play their part in showing that you care for their welfare.

But there's an important difference in adding a living benefit such as Group Critical Illness to your staff protection package. The simple fact is that risk protection of this kind can benefit you as much as it does for your employees. It puts you in the position of being able to boost the financial security of your staff if they fall victim to serious illness - without having to pay too high a price yourself. Most important of all, it helps you to face up to the moral dilemma of caring for a stricken member of staff and their family. Group Critical Illness protection, such as that offered by Royal SunAlliance, is also designed to supplement other employee benefits such as permanent health insurance. Although permanent health insurance offers income replacement for a disabled employee, Group Critical Illness focuses on the immediate cash needs which may arise as a result of a serious illness.

The core benefits for your employees are:

- The certainty of receiving a capital lump sum payment if serious illness should strike.
- Protection against the most commonly suffered critical illnesses, including cancer, stroke, heart attack and kidney failure.
- Benefits paid tax-free just 30 days after diagnosis and survival of a covered condition.
- Cash to help them put their lives together, clear their debts, cover household bills or pay for a holiday.

Even smaller companies with ten employees upwards can offer their staff the protection of Group Critical Illness cover. The cost can be as low as about £50 a year for which, each employee could receive a cash sum of £25,000 upon suffering a critical illness.

## Further Information

If you feel that you should take out critical illness insurance or want to discuss it with an expert, you should speak to an independent financial advisor.

This publication is for general interest - it is always essential to take advice on specific issues.

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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Publication issued or updated on: 5 April 2012

Ref: 351



## Reference

<sup>1</sup> See Bloomberg Money, April 1999, Page 50.