



Insurance Planning

One financial aspects of partnership is insurance

1. Disability insurance
2. Life insurance
3. Professional liability insurance

Your law firm may have an established insurance package, which you may be required to join or may join if you wish. Or, you may be on your own to make your own decisions about the kind of personal insurance that you want.

1. Disability insurance: if you become unable to work

No one likes to think about the possibility of being seriously injured in an accident or becoming too ill to work. But it can happen to any of us.

Would you be able to support yourself (and your family) and fulfill your financial commitments to your firm if you became unable to work for a while or possibly forever?

First, you need to know your firm's arrangements in the event that a partner becomes unable to work.

- Is there disability insurance in place for each partner?
- If yes:
 - for how long does the coverage extend?
 - how much is paid out?
 - to whom is the benefit paid?
- At what point could the firm require you to leave after you have become disabled?
- What would happen if the partnership dissolves?
- Do you need your own disability insurance coverage?

When a partner is unable to work due to an injury or illness, the firm may, for a time, be able to cope with the extra client workload, continuing office expenses, and loss of the earnings normally contributed by the absent partner. However, if the partner's absence becomes long-term or permanent, both the firm and the disabled partner face challenges. The firm must be able to

maintain its profitability and provide appropriate on-going service to its clients. The disabled partner will need to continue to receive income.

Types of insurance to consider include:

- Business Expense Protection
- Disability Buy/Sell Plans
- Disability Income Replacement Coverage

Business Expense Protection

Business Expense Protection covers the customary costs of running a practice. It may cover expenses such as:

- Staff salaries
- Office rental/lease costs
- Telephone and other utilities
- Advertising
- Accounting fees
- Capital cost allowance or lease costs of equipment (e.g., computers)

Business Expense Protection allows a partner's contractual commitments to be met. Benefits from a typical plan begin after a waiting period (e.g., 15, 30, 60, 90 days), and continue for a designated number of months, usually 12, 18, or 24. Both the waiting period and the benefit period are set at the time the plan is established.

Disability Buy/Sell Plans

A law firm cannot afford to meet the cash requirements of a non-productive partner indefinitely, and the active partners are not likely to want to share profits with someone who is no longer contributing to the firm's revenue. A partnership agreement may therefore set out how the remaining partners' will fund the purchase of a disabled partner's ownership interest.

Disability buy-out policies are designed to provide the cash required to complete the buy-out, minimizing disruption to the firm's cash flow. After a designated period of disability, typically 12, 18, or 24 months, funds are provided by either lump sum or monthly installment, or a combination of the two with a down payment and subsequent installment payments.



Disability Income Replacement Coverage

For most people, Disability Income Replacement insurance is probably the most important insurance product to own. Disability insurance replaces your income in the event that you are unable to work due to illness or injury.

Most individual disability insurance policies also provide important optional benefits not usually included in group long-term-disability (LTD) policies.

These additional benefits may include:

- Future Increase Options (FIO) - The ability to purchase additional coverage as your income increases, without needing to provide proof of good health.
- Cost Of Living Adjustments (COLA) – Annual cost of living increases to your monthly benefit while you are on claim.
- Partial/Residual Benefits – Partial benefit payments if you are able to work only part-time or earn a reduced income.

Here are some questions to ask about a plan that you are considering. It is best to get expert advice and to do some comparison shopping before making a final decision.

- Is the plan non-cancellable and guaranteed renewable?
- Will the premiums change?
- What is the definition of total disability?
- What is the definition of partial/residual disability?
- Is there a qualification period of total disability required before partial/residual disability benefits are payable?
- What is the occupational definition – "true own occupation" as opposed to more restrictive definitions, such as "any occupation", which make it harder to collect on the insurance?
- What options are available? Important choices may include the option to purchase additional amounts of coverage in the future, regardless of health status; cost of living indexing; retirement earnings protection, etc.
- What, if any, types of injuries or illnesses are not covered? For example, some plans exclude stress-related disorders.



- What percentage of income will be paid? Is there a dollar limit?
- How is the benefit coordinated with other plans?
- Is rehabilitation offered? What benefits are paid during rehabilitation? How much is paid if you return to work for a trial period or on a part-time basis?
- Under what circumstances can benefits be reduced or stopped?
- Are discounts available when several partners are underwritten with the same insurance company?

In addition, ask the insurance agent/broker for information regarding the financial stability of the underwriting insurance company. This information includes, for example, TRAC Report, Standard & Poor's and A.M. Best ratings.

Disability insurance can be complex. For a more detailed article about this product and the differences from group Long-Term Disability products, you may wish to refer to the Education Centre at www.barinsurance.com.

Life Insurance

A partnership should not be vulnerable to dissolution because one of the partners dies before retirement, leaving the partnership unable to pay the deceased's estate the credit balance owed against the capital account. Having a life insurance policy for the value of each partner's capital addresses this possibility. They can then apply the death benefit received from the insurance policy to pay out the deceased's estate without recourse to partnership capital.

There are many ways to structure life insurance that is meant to benefit a partnership. In order to ensure a smooth transition, the life insurance structure must match the direction in your buy/sell agreement. There may be tax consequences for some structures and an accountant may provide valuable advice in this regard.

There are three general types of life insurance policies: term, universal, and whole life.

● Term Life Insurance

These policies provide a pure death benefit, payable until the insured reaches a specified age, commonly age 70, 75, 80, or 100. They are available with varying premium structures; those that increase periodically (typically every 5,



10 or 20 years), and those that are level (remain the same throughout the entire contract).

● **Universal Life Insurance**

Two components combine to form these policies: life insurance and a cash accumulation fund. The types of insurance offered in universal life policies can range from a yearly renewable term to a term to age 100 and the types of investments in the cash accumulation fund can range from fixed-income to mutual fund type investments.

Contributions to the cash fund are optional. Growth on the deposits is credited as interest, and can be used to pay future premiums due or accumulate on a tax-sheltered basis. Deposits to or withdrawals from the cash fund can be made with considerable flexibility, however cash withdrawals could be taxable. Financial advice before making withdrawals from this type of fund is recommended.

● **Whole Life Insurance**

Although less commonly used, these policies are offered by most insurance companies. As the name implies, they provide coverage for as long as the insured lives.

Unlike the previous two plans, these policies may participate in the insurance company's profits and distribute annual dividends. Dividends can be used to purchase additional insurance, pay premiums, accumulate interest, or be taken as cash, at the discretion of the policy owner.

Whole life policies accumulate a cash value, or reserve, which, depending on the specifics of the plan, may be guaranteed and may be used for several purposes, including:

- Funding future premiums
- Providing loans against the cash value (with interest charged)
- Paying premiums under an automatic loan feature
- Providing a cash payout on termination of the policy (not from death), net of any outstanding policy loans or unpaid premiums.

Evaluating a life insurance plan



Features to evaluate in life insurance policies include:

- For how long is the insured required to pay the premiums?
- Are future premiums guaranteed not to increase in cost? If they are scheduled to increase periodically, are the renewal rates guaranteed?
- In the case of term insurance, is the contract convertible to whole life or universal life without providing evidence of good health?
- What features are included in the coverage and what features are optional? For example, waiver of premium, which obligates the insurance company to waive premiums owing during a period of disability suffered by the insured, after a specified waiting period.
- What interest rate is payable on the cash fund of universal life plans? Is it guaranteed or variable? Can the investment experience a loss?
- Are discounts available when several partners are underwritten with the same insurance company?
- What is the anticipated total cost over the expected length of time for which the policy will be required?

Although the renewable term rates often appear to be the most economical initially, you also need to consider for how long you will need insurance. It may be advisable to exercise either the conversion privilege available on some term insurance policies at some point (a conversion privilege allows you to convert term insurance to permanent insurance without providing proof of good health), or to purchase a more permanent type of insurance such as Universal Life, Whole Life, or Term to age 100.

Professional Liability Insurance

It is recommended that you consult your law society rules regarding professional liability insurance. Be aware of the activities that are covered by the insurance, the deductible and how it is applied, and the extent of your responsibility for the errors of your partners and firm.

Make sure that the amount of your coverage is sufficient for the type of professional activities that you perform, including the degree of risk inherent in your work and the sums involved.



Check whether your compulsory professional liability insurance has a fixed limit for the indemnity period or a limit per claim. If there is an annual fixed indemnity limit and there already has been a claim you may have reduced coverage available and may wish to purchase additional coverage.

Guard against claims. Claims are most often the result of:

- Sloppy file management
- Missed limitation periods
- Simple, obvious errors, and
- Poor communications.

Insurance resources

Assuris was created to provide Canadian policyholders with protection, within limits, against loss of policy benefits in the event of the insolvency of their insurance company. With very few exceptions, insurance companies licensed in Canada to sell life or health insurance to the public are members of Assuris.

The limits on protection are based on the type of coverage held by an individual (e.g. disability insurance, life insurance, annuity products).

For more information about Assuris:

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250 Yonge Street, Suite 3110, P.O. Box 23, Toronto, Ontario, M5B 2L7.

Canadian Life and Health Insurance Association Inc. (CLHIA), which represents 99% of the life and health insurance companies in Canada, can provide further information on life and health insurance.

www.clhia.ca.

Life and Health Insurance Information Centre

800-268-8099.

1 Queen Street East, Suite 1700, Toronto, Ontario M5C 2X9.

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