The biggest life events that can derail your financial plan

The BMO Wealth Institute provides insights and strategies around wealth planning and financial decisions to better prepare you for a confident financial future.

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When Canadians were asked what keeps them up at night, their answers were remarkably consistent. Not surprisingly, all of the top answers provided were events that have the potential to have a devastating impact on both the lifestyle and financial situation of both individuals and families.

A survey conducted by the BMO Wealth Institute revealed that men are more likely to worry about retirement and the risks associated with the loss of employment, while women tend to worry more about the risks of premature disability.[1] The survey also revealed that on average, nearly 60% of Canadians feel largely unprepared financially to deal with these events.

	Men	Women
Having enough money for retirement	33%	23%
Your health or that of your partner/spouse	21%	24%
Losing your job or your spouse/ partner losing his or her job	19%	13%

Top life events that keep Canadians awake at night

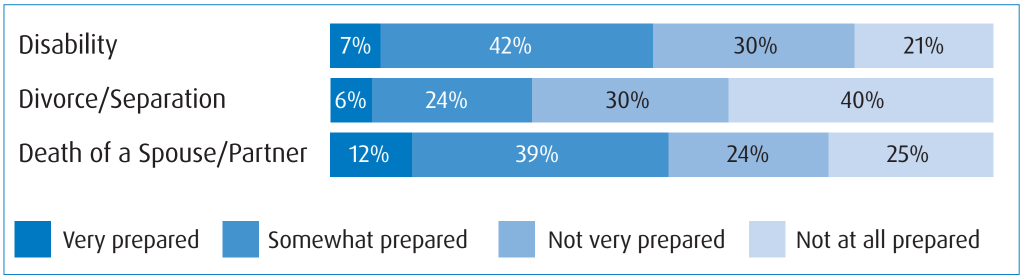
Source: BMO Wealth Institute survey by Pollara, March 2013

While 64% of Canadians have a financial plan, an overwhelming majority (80%) said that having a financial plan has helped them achieve their financial goals.[2] But just having a financial plan is not enough. One of the biggest mistakes individuals make is just having a plan that meets their goals, but not stress testing that plan to make sure that it can withstand not only a major decline in financial markets but also the major life events that keep Canadians awake at night. The most significant derailments to a financial plan are the death or disability of a spouse, partner or family member and divorce, particularly later in life. But only a small minority of Canadians said that they are **very prepared** to withstand any of these life events, which may suggest that very few people stress-tested their financial plan against these potential financial derailments.

60% of Canadians feel largely unprepared financially to deal with major life events.

Significant derailments to a financial plan are **death**, **disability**, and **divorce**.

Very **few people have stress-tested their financial plan** against these potential financial derailments.



Are Canadians stress testing their financial plan? How many are prepared?

Source: BMO Wealth Institute survey by Pollara, March 2013

All of these major life events can have a dramatic effect on a family's financial plan. These disruptions can cause a loss of income and likely lead to additional unplanned spending. This double shock will not only bring the ability to save to a standstill, it will also lead to the premature withdrawal of savings that had been set aside for future goals, such as retirement. It is no wonder that the survey showed that the fear that is most likely to keep Canadians up at night is the stress of not having enough money to retire. At least three in four respondents said they would be facing a major or catastrophic financial hit in the event of disability (84%), the death of their spouse/partner (76%) or divorce/separation (75%). When a financial plan does not take into account these potential derailments, the funds used to deal with these events when they arise are often the funds that had been set aside for future goals such as retirement.

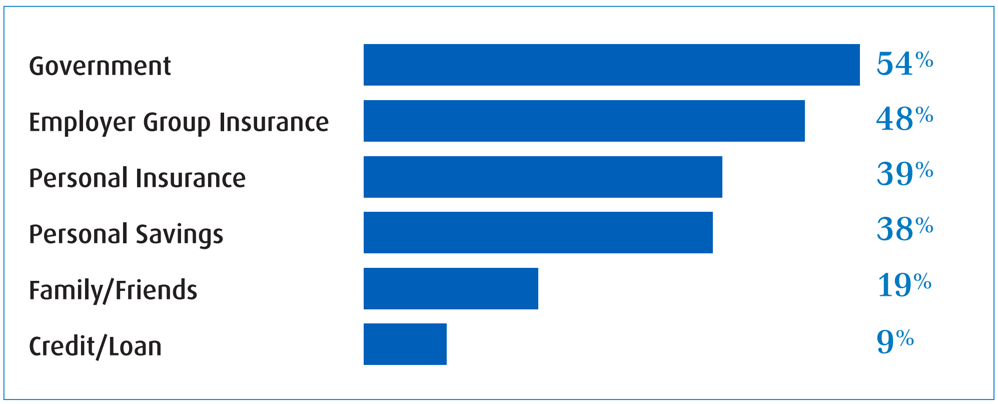
While the financial impact caused by derailments can be very hard, there are ways that families can plan for and insulate themselves from the worst of the financial impact. Taking a practical and proactive approach to these potential risks allows families to implement changes to their financial plan that can help put them in a more secure financial position and provide some peace of mind.

Major life event disruptions can cause a loss of income and likely lead to additional unplanned spending.

At least **three in four would be facing a major or catastrophic financial hit** in the event of disability, death or divorce.

Most Canadians don't anticipate the major effect a disability or illness can have on a financial plan

Most individuals will be able to have the retirement they envision if they work through to their retirement day and follow their financial plan. But consider the impact that a devastating disability or illness could have on that financial plan. What if an individual was forced to retire at age 55 instead of at the planned age of 65? Loss of income, drawing down on savings and medical costs over and above what is covered by the family's group plan or by government funded health programs can quickly add up and become a financial burden on a spouse or family. The impact can be even more devastating if you are single and have no one else to rely on for financial support.



Financial resources drawn on in event of disability

Source: BMO Wealth Institute survey by Pollara, March 2013

Survey respondents indicated that they would draw on many sources to help make ends meet in the event of disability. In addition to personal savings, family and friends, credit and insurance, a majority (54%) indicated that they would intend to look to the government for support. Unfortunately, support from the government is limited. The Canada/Quebec Pension Plan (CPP/QPP) disability benefit is capped at a maximum amount of just over $1,200 per month, with the average payment being far less.

Disabilities are not always the result of a terrible accident. An illness that slowly takes over one's ability to function at a normal level can be equally catastrophic. Between the age of 45 and 64, the chance of becoming disabled and unable to work is almost one in five. Statistics Canada notes that 17.3% of males and even a higher proportion of females, 19.3%, in this age group will become disabled before the retirement age of 65.[3]

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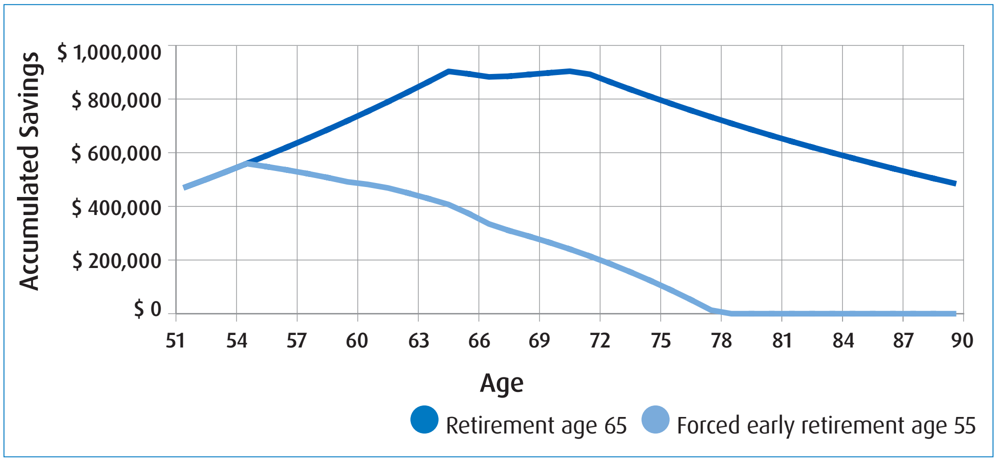
However, few Canadians appear to be prepared to withstand the impact of a critical illness or disability. For example, by the end of 2011, only about 4% of Canadians were covered under a critical illness plan, on either a group or an individual basis.[4] As for long-term disability, only 40% of Canadians have disability income insurance coverage.[5]

40% of Canadians have disability income insurance coverage.

The financial impact of disability or major illness

Consider a couple whose financial plan gets derailed 10 years early, at the age of 55. The dual impact on their financial plan of less income coming in and potentially more spending can turn a financial plan from one that had been accumulating savings to last until at least age 90 to one where all of the family's savings will be exhausted by the age of 77.



The devasting impact of a disability/major illness before retirement

Source: BMO Wealth Institute.

Assumptions: Accumulated savings in registered and non-registered accounts; 3% inflation rate; 3% rate of return (Interest); $48,000 indexed withdrawal per year. A couple, both age 51 and working, are on track with their financial plan for retirement when they reach age 65. Their financial plan becomes derailed when one suffers a life-changing disability at age 55 and is no longer able to earn an income.

A financial **plan becomes derailed when one suffers a life-changing disability** and is no longer able to earn an income.

Proactively planning for an unexpected disability or illness

In order to prepare for the financial impact of an unexpected disability or illness, families or individuals can build an emergency fund and consider their insurance needs. An emergency fund could be a source of income to help cover costs during a short-term disability. Consolidating funds held in smaller accounts across multiple financial institutions can simplify building and managing such an emergency fund.

A tax-free savings account (TFSA) is an investment account that can be used to accumulate funds for future needs without having to pay any taxes on the income generated. Current annual contributions limits are $5,500 per person, and the unused TFSA contribution room is carried forward and accumulates for future years. Since the inception of the TFSA in 2009, the cumulative contribution limit is $25,500 per person.

Insurance could also be considered to help reduce the potential impact of a disability on the family's financial plan. Insurance products that could be considered include income replacement insurance, critical illness insurance and long-term care insurance.

Nearly half of those surveyed would rely on disability insurance coverage through their employer group benefit program. However, group plans typically define disability as the inability to do your own job for the first two years, and then switch the definition to the inability to do any job. As many disabilities can last for years, depending only on group disability coverage leaves a financial plan more at risk after the first two years. For this reason, it may be beneficial to consider supplementing a group disability plan with a personal disability insurance plan.

Disability or income replacement insurance can be purchased on an individual basis and used to replace lost earned income by providing a monthly benefit to the disabled party. As disability insurance benefits are generally paid tax-free, a smaller income stream will have the same after-tax value as the much larger salary it replaces.

Another form of insurance to consider is critical illness insurance. While the thought of a spouse having a critical illness such as a heart attack or a cancer is frightening, receiving a lump sum coverage benefit shortly after diagnosis will help the family deal with unexpected costs, or help meet current cash flow needs. Many critical illness policies can even provide for a return of premiums if no benefits are paid under the policy. Policies are also available that cover specific illnesses, such as particular female cancers, that provide unique benefits that are related to the treatment requirements for those illnesses.

To prepare for the financial impact of an unexpected disability or illness, **build an emergency fund** and consider insurance.

Consider income replacement, critical illness and long-term care insurance to **reduce impact** on financial plan.

Long-term care insurance is an option that can be used to pay for the costs of continuing care well into retirement.

By planning for the long term, and considering the needs of the whole family, it is possible to put in place plans to reduce the stress that a disability or illness can have on the family's financial plan.

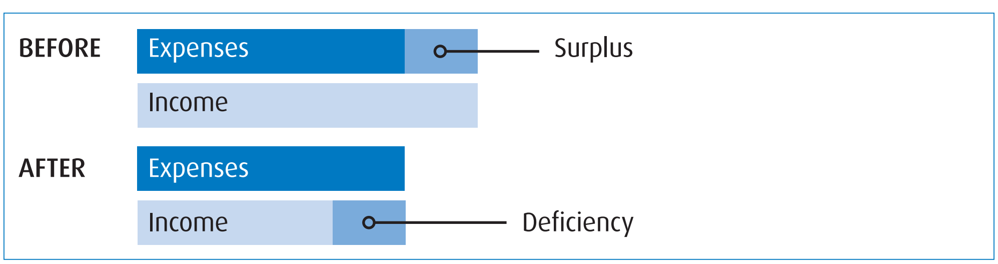
Death Lack of planning can lead to significant consequences

Of the three life events referenced in this report, the premature death of a spouse or partner is the one most likely to have a catastrophic financial impact, yet only 6% of respondents said that they are most worried about the premature death of their partner.

Surprisingly, the incidence of death during the pre-retirement years is relatively common. The average age of widowhood for women in Canada is 56.[6] Further, the mortality rate for Canadians aged 45 to 64 is 12.3% for men and 7.8% for women, and although the probability of dying remains low until about the age of 35, it steadily increases at middle age and beyond for both men and women.[7]

The financial impact of widowhood

The financial impact of suddenly becoming single due to the death of a spouse can be substantial. For instance, consider a couple with no life insurance. If one spouse were to pass away prematurely there could be a double shock: income stops, but the bills and expenses continue to come in. Depending on the deceased spouse's responsibilities in the home, the loss will require significant adjustments. Continuing income will be required; the household will have to be maintained and any minor children cared for. This can result in additional costs that the surviving spouse may have to cover, such as childcare expenses.



Potential double shock of widowhood

Source: BMO Wealth Institute survey by Pollara, March 2013

Long-term care insurance can be used to fund continuing care in retirement.

Premature death of a spouse or partner is most likely to have a catastrophic financial impact, yet **only 6% are most worried.**

Double shock
Income stops, but the bills and expenses continue.

To fund the shortfall, our survey revealed that individuals would turn to a wide range of sources: personal insurance (50%), the government (49%), employer group insurance (43%) and personal savings (42%). As savings are used up, the long-term financial goals of the financial plan are necessarily sacrificed.

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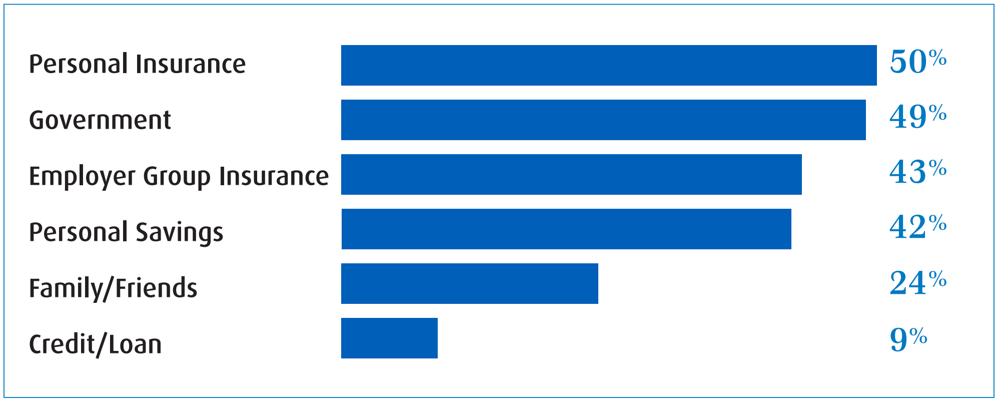

Financial resources drawn on in the event of a death

Source: BMO Wealth Institute survey by Pollara, March 2013

Planning to reduce the financial risks

For a person now unexpectedly single, this life-changing event requires a review of beneficiary designations, wills and power of attorneys, and a re-examination of the financial plan.

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There are many insurance options available that are worthy of consideration. Permanent insurance and temporary insurance each have a specific role to play in the protection of surviving family members. Term insurance is especially useful to cover risks that have a defined time period, such as the remaining amount of a mortgage, an education fund for the children and income replacement needs.

Permanent and temporary insurance each have a specific role to play in the protection of surviving family members.

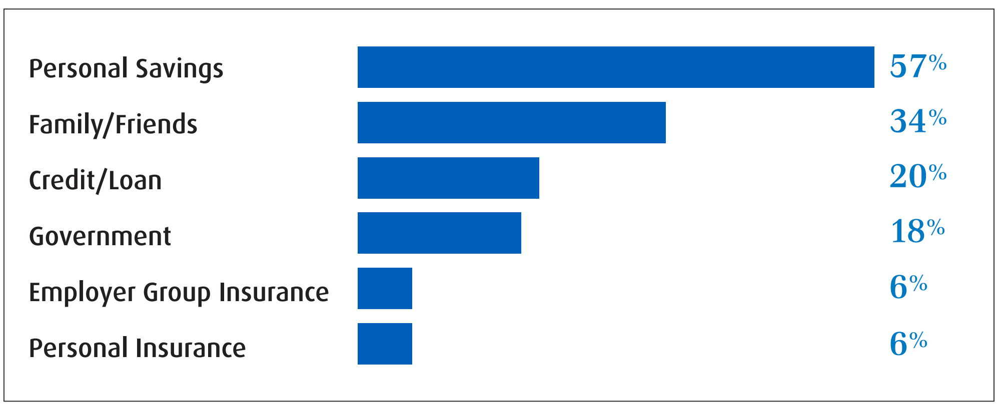
Permanent insurance is often considered for risks that are more long term in nature, such as providing for a surviving spouse should one's death occur later in life. Permanent insurance also provides the opportunity to build up savings on a tax-deferred basis. This accumulation of a cash value inside of a permanent insurance policy can be used as an emergency fund or used to pay out a disability benefit. A waiver of premium on disability rider could be purchased as part of the insurance policy, which would help if a disability occurred. With permanent insurance, it is possible to prefund the costs associated with a policy, so that no payments are required during retirement.

As there are many insurance options available, it is very important to consult a qualified professional regarding different types of policies and their uses.

Suddenly divorced – now what?

Becoming unexpectedly single can also occur when a relationship ends due to divorce, particularly if it happens later in life. In fact, the incidence of grey divorce has been on the rise. In Canada, the only age group that is seeing a rise in divorce are couples over 50.[8] The impacts extend well beyond family issues and the children. The financial impacts must also be considered, as divorce could result in each of the ex-spouses and the children having a lower standard of living than they previously enjoyed. By dividing what was once a single nest egg into two, less may be available to help meet future needs, as many expenses, such as housing and utilities, increase as the result of having two separate residences.

Our survey confirmed the double shock that a divorce or separation could bring, that is, loss of income and additional unplanned spending. In fact, the majority (70%) of respondents said they would be unprepared financially to withstand a divorce or separation, which was a larger proportion of respondents than in the case of the death of a partner (49%) and disability (51%). Not surprisingly, they would be more likely to rely on personal savings (57%) or family and friends (34%) to support themselves during such a potentially challenging financial strain. Of all three life events, divorce is the one where our survey found people would be most likely to depend on credit and loans (20%) as an essential source of funds, compared with the case of a disability (9%) or the death of a partner (9%).



Financial resources drawn on in the event of divorce or separation

Source: BMO Wealth Institute survey by Pollara, March 2013

Unfortunately, the incidence of divorce continues to be relatively high. It is now expected that about four in ten marriages in Canada will end in divorce. No one enters marriage planning for divorce, but if you find yourself suddenly single, there are steps that you can take to recalibrate your finances. Women, in particular, should bear this in mind, as according to a Statistics Canada study, 43% of Canadian women who have undergone a divorce or separation had a substantial decrease in household income; in contrast, only 15% of separated or divorced men experienced a similar financial decline.[9]

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The key to financial survival through the often difficult process of obtaining a divorce is to have your financial house in order. As a starting point, recalibrate – that is, review and update the financial plan, as it will be under significant stress as a result of the divorce. A financial plan can help highlight any necessary adjustments to your current financial situation to meet your future goals, based on your new level of income, expense, assets and liabilities.

Beneficiary designations on life insurance policies, group insurance through employee benefit programs, RRSPs and TFSAs should all be reviewed to determine if changes are required to remove the ex-spouse. You should also work with your qualified legal advisor to review your will and power of attorney, and either adjust or rewrite them to make sure that the heirs, executors, attorneys, trustees, and guardians (for minor children) named meet your updated wishes. Ensure any properties or accounts that were jointly owned are switched to single ownership. (Note that this should only be done under the strict guidance of your qualified legal advisor, to ensure the division is equitable and that it reflects the family laws in the jurisdiction in which you live.)

Determine if insurance coverage is required, as spousal coverage on employee group plans typically ends as a result of divorce. Life insurance, protection against disability and health benefits insurance should all be re-examined following a divorce.

You should work with your financial professional to update your credit and eliminate any joint responsibilities or guarantees that may be in place for your ex-spouse. Ensuring your credit is on a firm foundation will provide greater access to a personal line of credit or a credit card in your name to help with the transition forward.

Recalibrate – that is, review and update the financial plan, as it will be under significant stress as a result of the divorce.

Conclusion

There are many other events that could have a significant financial impact on the family. An unexpected career change as a result of a downsizing or employer bankruptcy can cause financial distress similar to that resulting from the life events discussed above. Or, on the positive side, a family might be the recipient of a sizeable inheritance.

We believe proactive planning and professional advice go hand in hand. By working with a BMO financial professional who understands the impact of these derailments on a financial plan, and who can also make the appropriate referral or introduction to other key professionals, Canadians can develop a thoughtful plan and enjoy greater peace of mind.

To learn more about protection and peace of mind, visit **www.bmo.com/home/personal/banking/financial-planning/planning-for-the-future/insurance**

Footnotes

1 BMO Wealth Institute study conducted online by Pollara with a random survey sample of 800 Canadians 18 years of age and over who are not yet retired and in a married or in a common-law relationship, between March 15 and 19, 2013.

2 BMO Financial Group study conducted online by Pollara with a random survey sample of 1,000 Canadians 18 years of age and over, between September 6 and 10, 2012.

3 Statistics Canada, Participation and Activity Limitations Survey, 2006.

4 Canadian Life and Health Insurance Association Inc.

5 Ibid.

6 Statistics Canada, Women in Canada: A Gender-based Statistical Report, 2005.

7 Statistics Canada, Health Statistics Division, Vital Statistics, Mortality: Overview 2007, Data table for Figure 2, Age pyramid of deaths, 1921, 2007 and 2060 (projected), relative value, 2011.

8 Anne Kingston, "Divorce on the Rise among Those over 50," Maclean's, January 29, 2007.

9 Statistics Canada, 2006 National Population Health Study.

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