The Financial Advisor Guide to Life Insurance Basics
Self Study Course # 1
AN INTRODUCTION & OVERVIEW TO LIFE INSURANCE BASICS

In this course, the student will cover the following:

- How Life Insurance began and developed throughout the years.
- Types of Insurance Products and how they are different from each other.
- Other Insurance products – What are they? How do you use them?
- Insurance Contract provisions – What are they? How do they affect your policy?
- What are your legal responsibilities as an Agent or Broker?

THE ORIGINS OF LIFE INSURANCE

The Industry of Life Insurance as we know it took a long time to develop. Originally, the sale of Insurance was consumer driven and it was not until the middle of the 1800’s that the first vestiges of a marketing system appeared.

Today, of course we know it as the Agency System. This grew slowly and finally developed into the large-scale endeavor that was characteristic of the first 70 years of the 20th century.

Let’s take a look…

Almost 4,500 years ago, in the ancient land of Babylonia, traders used to bear risk of the caravan trade by giving loans that had to be later repaid with interest when the goods arrived safely. In 2100 BC, the Code of Hammurabi granted legal status to the practice.

That, perhaps, was how insurance made its beginning. Life insurance had its origins in ancient Rome, where citizens formed burial clubs that would meet the funeral expenses of its members as well as help survivors by making some payments.

As European civilization progressed, its social institutions and welfare practices also got more and more refined.
With the discovery of new lands, sea routes and the consequent growth in trade, medieval guilds took it upon themselves to protect their member traders from loss on account of fire, shipwrecks and the like.

Since most of the trade took place by sea, there was also the fear of pirates. So these guilds even offered ransom for members held captive by pirates. Burial expenses and support in times of sickness and poverty were other services offered. Essentially, all these revolved around the concept of insurance or risk coverage. That's how old these concepts are, really.

In 1347, in Genoa, European maritime nations entered into the earliest known insurance contract and decided to accept marine insurance as a practice.

The first step...
Insurance as we know it today owes its existence to 17th century England. In fact, it began taking shape in 1688 at a rather interesting place called Lloyd's Coffee House in London, where merchants, ship-owners and underwriters met to discuss and transact business. By the end of the 18th century, Lloyd's had brewed enough business to become one of the first modern insurance companies.

Insurance and Myth...
Back to the 17th century…. In 1693, astronomer Edmond Halley constructed the first mortality table to provide a link between the life insurance premium and the average life spans based on statistical laws of mortality and compound interest. In 1756, Joseph Dodson reworked the table, linking premium rate to age.

Enter companies...
The first stock companies to get into the business of insurance were chartered in England in 1720. The year 1735 saw the birth of the first insurance company in the American colonies in Charleston, SC.
In 1759, the Presbyterian Synod of Philadelphia sponsored the first life insurance corporation in America for the benefit of ministers and their dependents. However, it was after 1840 that life insurance really took off in a big way. The trigger: reducing opposition from religious groups.

**The growing years...**

The 19th century saw huge developments in the field of insurance, with newer products being devised to meet the growing needs of urbanization and industrialization.

**MYTHS ASSOCIATED WITH LIFE INSURANCE**

Most consumers shop for and buy life insurance without understanding how a life insurance company sets rates. The internet today brings customers behind the scenes and uncovers the inner workings of insurers. A good online life insurance service can be the easiest and certainly the most accessible way to find the best rates, if this is important to the client and prospect.

*With this said, it is always better to deal with an agent or broker on a face to face basis.*

**MYTH**

Insurers have similar ways to underwrite policies and all are pretty much the same in their methodology.

**FACT**

While there are similarities, each life insurance company has a distinct way that they underwrite or set insurance rates. Diverse factors contribute to how an insurer sets rates. An experienced insurance agent knows how to direct clients through the maze of factors and different insurance companies toward the right policy.
**MYTH**
Life insurance companies measure risk for populations, not individuals.

**FACT**
For individual life insurance, companies measure risk through a combination of broad population statistics on length of life plus a review of each individual’s health history. The factors looked at mirror the kinds of things one’s physician might look for in reviewing one’s health; including cigarette smoking, cholesterol, ratios of good cholesterol to bad cholesterol, weight, adverse medical history and participation in dangerous recreational activities (for example: skydiving or motorcycle or auto racing). If an activity or health concern, in general, might shorten a life span, it could factor into the life insurance rate.

**MYTH**
Everyone at the same age is charged the same for life insurance.

**FACT**
Women are charged less for life insurance at the same age as men because, statistically, women live longer than men.
The key factors determining life insurance rates are in order; Age, health history, gender, medical history of parents and siblings and lifestyle factors such as certain recreational activities.

**MYTH**
People with questionable medical histories usually cannot get insurance.

**FACT**
What life insurance companies call “higher risk” people can often get “rated policies.” Rated policies carry an extra charge to account for the risk but can usually be found for people with health or lifestyle issues. Sometimes one company will charge extra while another will not.
**MYTH**
People in a high-risk rating category are at the mercy of life insurance companies when determining rates.

**FACT**
A good insurance agency or brokerage has experience discovering which life insurance companies have the best rates for different medical conditions or situations. They make insurance companies compete to find the most competitive rates for clients in higher rating categories. This is often different from a local agent who may have less access, may not have the knowledge base or is tied to only one life insurance company.

**MYTH**
There is not much variability among the rates charged by insurance companies for term life insurance or any of the types of life insurance.

**FACT**
Different rating factors lead to immense variability between rates charged by different companies. Comparison shopping pays off and a good online life insurance agent can serve as an excellent comparison shopper.

**MYTH**
Insurers will never know if I fib a little on my application.

**FACT**
Insurers are used to doing extensive background checks and can catch inaccuracies, not to mention the fact that all insurance companies in Canada use the Medical Insurance Bureau (MIB). The best strategy is to be as truthful as possible and use an experienced agent to search out a policy that takes all factors into account.
MYTH
Rates determined based on risk factors like smoking or skydiving are fixed and can never decrease.

FACT
Over time, as health improves, if one loses weight and keeps it off or quits smoking for a number of years, one can reapply to lower one’s insurance rates. There’s no downside to this, since once issued, a life insurance policy’s rates could go down but contractual rates on a life insurance can not be changed, once a policy is issued and paid for, if your health or personal activities change.

HISTORY OF THE CANADIAN INSTITUTE OF ACTUARIES
The Canadian Institute of Actuaries (CIA), the national organization of the actuarial profession in Canada, was established by an Act of the federal parliament on March 18, 1965. Since its formation, the Canadian Institute has grown steadily to its present size of about two thousand, five hundred member Fellows.

Actuarial thought and practice have a long history in Canada. The beginning of the actuarial profession in Canada can be dated in 1847, when the Canada Life Insurance Company was founded in Hamilton, Ontario by Hugh Baker, who became a Fellow of the Institute of Actuaries in 1852. The federal Department of Insurance was established in 1875 and shortly thereafter recruited actuaries to its staff. The first actuarial organization in North America was the Actuarial Society of America, founded in 1889 in New York and included four Canadians among its thirty-eight Charter Members.

The original organization of actuaries in Canada, the Actuaries Club, was founded in 1907 with 24 charter members, all actuaries living and working in Toronto.
The Canadian Association of Actuaries was established October 8, 1946 and included all members of the Actuaries Clubs of Toronto and Winnipeg as well as a group of Montreal actuaries. This was the organization that formed the membership basis of the CIA in 1965.

According to the federal Act which incorporated the CIA, The purpose and objects of the Institute shall be:
- To advance and develop actuarial science,
- To promote the application of actuarial science to human affairs, and
- To establish, promote and maintain high standards of competence and conduct within the actuarial profession.

Following competitions, the Institute adopted the motto Nobis Cura Futuri, meaning, “We care about the future.”

Within a few years, the need for a truly bilingual CIA was identified as a means of recognizing Canada’s official languages policy, of improving service to members, and of strengthening the actuarial profession across Canada. A formal bilingualism policy, requiring that all publications of the Institute be available in both French and English and that simultaneous translation be provided at all general meetings, was adopted by the Institute’s Council in 1977.

Statutory recognition of Fellowship of the Canadian Institute of Actuaries came rapidly. None of the provinces saw fit to license actuaries, but they made full use of the FCIA (FICA, en français) designation. Regulations under the Ontario and Quebec pension plan legislation required noninsured pension plans to be valued at least once every three years by an FCIA, and that a cost certificate be filed. Other provinces followed this example a few years later. Many Acts relating to public sector pension plans also require certification by an FCIA.
Even before 1965, the statements of insurance companies transacting life and health insurance in Canada had to be signed by an actuary who was a Fellow of a recognized actuarial body. With the advent of the CIA, most Canadian jurisdictions introduced the requirement that the actuary be an FCIA. A similar requirement became effective for federally registered property/casualty insurers in 1992 and also, at that time, for provincially registered property/casualty companies in Quebec and Ontario. In anticipation of these property/casualty insurer requirements, the CIA undertook a special program in the late 1980s to increase the number of qualified property/casualty practitioners.

The Institute’s examination system has evolved to meet the needs of the profession and the changing social background. The early examinations are co-sponsored by the Canadian Institute of Actuaries, the Society of Actuaries, and the Casualty Actuarial Society. The later examinations of the Society of Actuaries are also co-sponsored by the CIA.

The examinations of the Society of Actuaries had, during the 1990s, been modified to provide a Canadian option and a United States option in a number of the later examinations dealing with taxation, law, social security and the like. Only an actuary who had passed the Canadian options could be granted Fellowship in the Canadian Institute of Actuaries. In addition to opting for the United States or Canadian streams, a student of the Society of Actuaries could choose to concentrate on group benefits, individual life and annuity risks, pensions, or finance and investments. As co-sponsor, the CIA has an influential voice regarding examination content and methods, particularly as they affect Canadians. Examinations can be taken in various cities in Canada and, in the main, are bilingual.

In 2000, the Society of Actuaries examinations were modified and, in the process, the later examinations were changed to be less nation-specific.
Consequently, in order to demonstrate knowledge of Canadian practice, FCIA candidates writing the Society of Actuaries examinations are now required, as well, to complete the CIA-administered Practice Education Course (PEC). The PEC offers separate courses in insurance, group benefits, pension, and investment/finance areas of practice and in all cases concludes with a written examination.

Similar policies are pursued with the Casualty Actuarial Society, which specializes in property/casualty risks. For the later examinations, the Casualty Actuarial Society conducts separate exams that are jointly sponsored by the Canadian Institute of Actuaries and which incorporate Canadian content. Actuaries from the United Kingdom and other countries are also required to complete the CIA’s Practice Education Course to demonstrate that they have adequate knowledge of Canadian practice before they can be admitted as Fellowship in the Canadian Institute of Actuaries.

The Canadian Institute of Actuaries (CIA) and its members are active in the international actuarial community. The CIA was active in the 1998 restructuring of the International Actuarial Association and prides itself in being a founding member of that body. In fact, the IAA Secretariat is co-located with that of the CIA in Ottawa.

INSURANCE PLANNING AND RISK MANAGEMENT

In our daily lives, we face risks. A certain degree of risk makes life more rewarding and exciting, but our task is to find the dividing line between what acceptable risk is and what is not.

There is a large difference in the degree of risk in learning how to downhill ski and being a stunt pilot performing in air shows.
Most of our risk management deals with our families well being and ourselves. The definition of risk therefore is the probability of harm, injury due to loss, danger or destruction occurring in the future. These losses can be emotional, physical or financial. The primary purpose of this section is to deal with financial risks.

Risk Management is the cornerstone of any financial planning effort. It makes no difference how elaborate or effective the investment portfolio, the retirement plan, or the estate plan, if you have not taken the necessary steps to eliminate risk, all remaining planning efforts could be pointless. Risk management through the wise use of insurance removes the concern for the unknown from a financial plan.

The sale of Life Insurance did not become wide spread until the buyers understood the concept of “risk sharing.” Insurance is a method of sharing or transferring risk from an individual to a group so all members of the group share losses on an equitable basis. The price of this sharing of risk is called the premium. In effect, you trade the potential for a large loss (an accident resulting in death) for a small loss (your premium).

**Principals of Insurance and Risk**

*Not all risks can be insured, nor can all individuals obtain insurance.*

An individual risk is reduced when shared by many. Each individual contributes a fair share for the safety of all. The share contributed is small in relations to the risk of a large cost.

The acceptance of Elizur Wright’s net valuation tables by the Insurance Companies gave rise to the legally required reserves that in turn produced the policy values known as non-forfeiture provisions.

It took the development of mortality tables and the development of Actuarial science to build the industry to the economic force it is today.
Insurance is available, according to the following principals:

- A large number of similar units must be exposed to the same risk. This makes the prediction of total losses for the pool reasonably accurate.
- The potential losses must be definite and measurable. The insurer must be able to assign an economic value to the loss.
- The potential loss must be fortuitous or accidental as opposed to intentional, and beyond the control of the insured. Certain losses and intentionally caused losses could result in depreciation not being covered.
- The potential loss cannot be so great that it eliminates the entire pool of similar units, or produces such wide spread destruction that it wipes out entire areas. This is known as catastrophic loss.

**TYPES OF INSURANCE RISKS**

Risk can be divided into two types:

1) **Speculative Risk** involves three outcomes:
   - a) Loss
   - b) No Change
   - c) Gain

2) **Pure risk** has two alternative outcomes:
   - a) Loss
   - b) No change

**Speculative Risk**
When you wager on the ponies, you have the opportunity to make money, lose your money or regain your original wager. We are going to focus on pure risk.

**Pure Risk**
If you chose not to insure your life, you are taking a pure risk. Your life could be ended in an accident or if no accident occurs, there is no loss.
There are four main types of pure risk:

a) **Personal Risks**
These risks include death, disability, old age and unemployment. Through death or disability, loss of income can seriously affect the family’s lifestyle.

b) **Property Risks**
Material possessions can be lost through damage or theft. Direct loss if your house is fire damaged indirect loss if you have to seek temporary shelter.

c) **Liability Risks**
We are subject to punitive damage, if a court finds we were liable, and our actions caused property damage, personal or financial loss.

d) **Failure of Others**
This is a non-performance risk by others who fail to fulfill a contract or obligation to you.

**PERILS AND HAZARDS**

*Losses come as the result of two situations:*

1. **Perils**
Are losses as the result of death, disability, illness, accident, lawsuits and dishonesty?

   All pure risks contain perils.

2. **Hazard**
Hazards are acts or conditions that increase the probability of a peril or affect the severity of loss, such as leaving your house unlocked during absences.

   Hazards can be physical, moral or morale.
The unlocked house is a physical hazard. The individual who enters and steals possessions created a moral hazard and the owner who left the house unlocked created a moral hazard.

THE PROCESS OF MANAGING RISK

The goal of Risk Management is the reduction of the possibility of financial loss and personal harm. The purpose is that by identifying risk, you can eliminate hazards that cause perils.

There are five steps in the Risk Management Process:

1. **Setting Objectives**

   The primary risk management objective is protecting the family in the event of the death of disability of the primary wage earner.

   The second most important objective would be the protection of the family home against theft and/or damage.

2. **Identifying Risks**

   Identifying risk involves a review of your financial and family situation as well as your lifestyle.

   Financial
   - Valuation of all property.
   - Income from all sources.
   - Statement of cash flow (including outflow).
   - List of assets, including emergency funds.
   - List of debts, including final expenses.
Family

- Number of family members
- Ages of any dependents
- The ability of any survivors to handle finances.
- Any physically/mentally challenged family members?
- Other health challenges?

Lifestyle

Hazardous occupations, sporting activities or personality types (Type A) should be evaluated for risk.

_All risks should be evaluated as to severity:_

- Is the risk critical? Any occurrence could lead to bankruptcy.
- Is the risk Important? Any occurrence could lead to reduction in lifestyle.
- Is the risk material? - All other information and any other risks.

In addition, risk can be classified as low, moderate or high. It would be wise to apply this classification at the same time as determining severity.

3. **Selection Strategies**

_There are two methods of managing your risks:_

A. Risk Control - Deals with limiting your exposure to risk.
B. Risk Financing - Involves sharing, transferring or retaining the cost associated with risk.

**FOUR MAIN RISK STRATEGIES:**

A. Risk avoidance
B. Risk reduction
C. Risk sharing or transfer
D. Risk assumption or retention
The first two categories deal with risk control methods, the last two with risk financing.

**A. Risk Avoidance**
Risk avoidance involves the giving up of discretionary activities that have high frequency and high severity risks.

This means that you are willing to forego the activity, to avoid the risks involved. Motorcycle racing on a local dirt track every weekend, might be a good example.

**B. Risk Reduction OR Loss Management and Control**

This technique involves lowering the probability of a particular hazard occurring; and lessening the severity of the hazard by taking some positive action.

Risk reduction measures are appropriate for all high frequency `risk, regardless of severity. The tools used include adopting safety measures, pooling segregating and diversifying.

**Safety Measures:**
Picking an alternative route, that takes 15 minutes more to arrive at work that bypasses a notoriously dangerous section of super highway.

**Pooling:**
Pooling or combining the exposure to risk with other similarly placed. Deciding to travel to work in a car pool. Insurance E & O insurance is another example.

**Segregation:**
Segregation prevents a single event from causing devastating loss to a business or family. The executives of a firm flying to Tampa for the annual meeting, all go on different flights.
Diversification:
This method divides risk amongst different units, so that a unit suffering a loss does not affect the other units operation.

C. Risk Transfer or Sharing
This technique almost always involves some form of insurance. The risk of a particular hazard is transferred to another entity (usually an insurance company) in exchange for a payment of premium. This process also involves the determination by the insurer of whether or not the risk to be assumed is acceptable at the given premium. This process is known as the “underwriting” process.

This is a method of financing risk. This works best with low frequency, high severity risk, such as death or disability.

Most Common Examples Are:
- Insurance Contracts
- Government Programs such as Social Security or Workers Compensation Board
- Credit Agreements
- Service/Maintenance Contracts

D. Risk Assumption or Retention
This technique involves the acceptance of the risk. Generally, this technique should be used only when the potential exposure is very small or has a low probability of occurrence. In other words, you should only self-insure what you can afford to lose. Unfortunately, many people self-insure by default.

They do not consciously decide to take-on the full risk; they merely fail to plan and provide for an adequate risk management program.
Sometimes partial risk retention is used, wherein the person at risk chooses to accept part of the potential liability for a certain hazard.

This is another form of financing. It is appropriate for high frequency, low severity risks. This method allows you to retain part of the cost if the risk is realized.

**Most Common Examples Are:**
- Co-Insurance and deductible.
- Waiting Periods.

4. **Evaluating Strategies**
Each individual has to analyze their situation and apply the most appropriate risk management and cost containment techniques.

5. **Implementing & Monitoring Strategies**
Put options into place. Systematic review will tell you whether your program is being successful.

**RISK & RETENTION**
Each Company that is a “direct writer” has a certain amount of risk that they will retain. Risk is the exposure to claim of the Sum Insured (or net amount at risk). This retention figure usually varies between $100,000 and $2,000,000.

Some companies will retain the risk on small policies completely and only seek reinsurance on larger policies. (Retention Limit). If a company arranges to pass or “cede” part of the risk, they put in place an agreement with an Insurance Company that specializes in reinsurance.

Some companies only provide reinsurance and some “direct writers” will reinsure other company’s excess risk. This agreement takes the form of an agreement called a “Reinsurance Treaty”.

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TYPES OF REINSURANCE

Reinsurance refers to insurance that is purchase by an insurance company to cover all or part of certain risks on insurance policies issued by that company. In other words, reinsurance is the transfer of insurance risk to another insurer for a price. The reinsurer agrees to provide coverage to another insurance company (known as the ‘ceding’ or ‘reinsured’ company) for all or part of the losses that the ceding company may incur under certain policies of insurance issued by the ceding company.

The fundamental principle of reinsurance is that a transfer of risk must occur, whether that risk relates to mortality, morbidity, lapse or surrender, expense, or investment performance. Under a reinsurance arrangement, a reinsurer can agree to participate in any one of these risks to varying degrees.

Through reinsurance, risks can be redistributed among several insurance companies. A reinsurer also occasionally cedes risks to another reinsurer in a transaction known as retrocession. In other words, retrocession is insurance for reinsurance companies. The reinsurance company that reinsures risks, ceded by another reinsurance company through retrocession, is known as a retrocessionaire.

Limiting the Exposure:
The “retention limit” limits the companies’ exposure to mortality or morbidity. The purpose is to provide for a consistent source of net income and to prevent insolvency or "reserve strain".

Reinsurance Treaties:
All treaties exist between the direct writer and the reinsurer and/or the retrocessionaire.
Reinsurance can be arranged in one of three types:

**Automatic Reinsurance**
A contractual arrangement whereby the reinsurer automatically takes on part of the risk according to certain agreed upon limits.

**Facultative Reinsurance**
The direct writer will send all pertaining documents and reports to the reinsuree who will decide on the amount of risk, if any, that they will accept.

**Facultative Obligatory**
The ceding Company (direct writer or reinsurer) decides on what risk to pass on. The reinsurer has the right to determine whether it has its’ retention limit on that individual life and may decline only if it is already fully retained.

**WHY REINSURANCE?**
The four primary reasons for buying reinsurance are to provide:
1. Financial support
2. Additional capacity
3. Catastrophe protection
4. Stabilization of results

**TYPES OF REINSURANCE**

**Proportional Reinsurance**
Proportional reinsurance (mostly known as quota share reinsurance) is where the reinsurer takes a stated % share of each policy the insurer writes and then shares in the premiums and losses in that same proportion. The size of the insurer might only allow it to write a risk with a policy limit $1 million but purchasing proportional reinsurance might allow it to double or triple that limit. Premiums and losses are then shared on a pro-rata basis. For example an insurance company might purchase a 50% quota share treaty; in this case they would share half of all premium and losses with the reinsurer. In a 75% quota share, they would share (cede) 3/4th's of all premiums and losses.
The other (lesser known) form of proportional reinsurance is surplus share. In this case, a "line" is defined as a certain policy limit - say $100,000. In a 9 line surplus share treaty the reinsurer could then accept up to $900,000 (9 lines). So if the Insurance Company issues a policy for $100,000, they would keep all of the premiums and losses from that policy. If they issue a $200,000 policy, they would give (cede) half of the premiums and losses to the reinsurer (1 line each). If they issue a $500,000 policy, they would cede 80% of the premiums and losses on that policy to the reinsurer (1 line to the company, 4 lines to the reinsurer 4/5 = 80%) If they issue the maximum policy limit of $1,000,000 the Reinsurer would then get 90% of all of the premiums and losses from that policy.

The Reinsurer will sometimes use the following to assist with Proportional Reinsurance:

Yearly Renewable Term
The direct writer purchases (net cost agreement based on age and duration) yearly renewable term on the excess net amount at risks that they do not want to retain. The direct writer retains the expense investment and lapse risks.

Co-Insurance
The risk is shared between the direct writer and the reinsurer on an agreed upon basis as to all the risk and premium. The reinsurer will pay back a portion of the premium to offset the ceding companies’ expenses.

Modified Co-Insurance:
In this arrangement, the reinsurer returns the reserve portion of the ceded premium to the direct writer for investment at a specific guaranteed rate of interest. Any excess interest earned falls to the direct writer. The reinsurer retains its’ portion of the mortality and lapse risk.
Non-Proportional Reinsurance (Excess of Loss)

Non-Proportional Reinsurance (or Excess of Loss) only responds if the loss suffered by the insurer exceeds a certain amount (retention). An example of this form of reinsurance is where the insurer is prepared to accept a loss of $1 million for any loss which may occur and purchases a layer of reinsurance of $4m in excess of $1 million - if a loss of $3 million occurs the insurer pays the $3 million to the insured(s), and then recovers $2 million from their reinsurer(s). In this example, the insurer will retain any loss exceeding $5 million unless they have purchased a further excess layer (second layer) of say $5 million excess of $5 million.

Excess of Loss Reinsurance can have two forms - *Per Risk or per Occurrence* (Catastrophe or "Cat"). In Per Risk, the insurance policy limits are exposed within the reinsurance limits. For example, an insurance company might insure commercial property risks with policy limits up to $10 million and then buy per risk reinsurance of $5 million in excess of $5 million. In Catastrophe Excess the insurance policy limits must be less than the reinsurance retention.

**The Reinsurer will sometime use the following to assist with Non-Proportional reinsurance:**

**Stop Loss Insurance:**
Under this type of arrangement the reinsurer will agree for a fixed premium to reinsure up to 100% (usually 80-90%) of the ceding companies exposure to claim above a certain fixed amount, called the "attachment point", e.g.

The agreement may call for 85% payment of all claims in excess of 125% of expected claims.

This type of reinsurance is inexpensive and is purchased by large direct writers in addition to other types of reinsurance.
**Catastrophic Reinsurance:**
Provides reinsurance against larger losses where more than one-person insured is killed in the same accident or catastrophe.

Generally, two or three lives are identified so it is called a two or three life warranty. This type of insurance is purchased in addition to other types of reinsurance and is useful in insuring against loss due to multiple claims such as an airline crash or natural disaster. It usually has a deductible and is used for Group Insurance or multiple life exposure.

All of these arrangements are subject to negotiation and may vary from company to company.

**LIFE INSURANCE IS AVAILABLE FROM MANY SOURCES**

**Private Insurance Companies**
There are several thousand private insurance companies, and they either operate a for-profit or non-profit organization.

For-profit companies are usually stock companies owned by shareholders and mutual companies owned by the policyholders.

**Co-operative Insurers**
Co-operative insurers provide insurance for their members. Examples would include Hospital Groups, Medical Groups and Fraternal Organizations.

**Government Insurance**
Both Federal and Provincial governments operate specialized insurance programs to manage societal risks. Most of these programs involve life, disability, health, property, automobile, public liability and bonds.

The insurance programs would include social assistance, public assistance and public insurance.
Social Insurance Programs Include:

- Canada and Quebec Pension Plans.
- Workers Compensation Benefits.
- Employment Insurance (EI).

Public Assistance Programs:

- Old Age assistance.
- Aid to the sight impaired and aid to dependant children.
- Medicare and Social Assistance.

Public Insurance Programs Include:

- Canada Mortgage and Housing Corporation (CMHC) insure mortgages.

Today the marketing system has further evolved into a three-tier system:

1. Agency System or Career Agency
2. Brokerage System or Managing General Agency (MGA’s)
3. Multiple Distribution systems

Simply put, life insurance agents are men and women authorized to help others buy and manage life insurance. This authority comes from the Province in which they live.

If you own any kind of insurance (car, health, home, boat, RV, pet, liability, etc.), you’ve probably already dealt with different insurance providers and their agents. An Insurance agent or broker works with customers to provide financial protection if an emergency or major event (death, disability or retirement) occurs.

In Canada, there are literally tens of thousands of individuals who are licensed to market life insurance products and working in the insurance industry in some position. A life insurance agent sets up various plans that the insured pays for in exchange for the promise that designated beneficiaries will receive a large amount of money when it is needed the most.

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An agent works for one company, while a broker works independently and can sell and manage policies through many companies. However, an agent is similar to a broker in many ways.

1. **Agency System or Career Agency**

A type of insurance sales distribution system wherein companies recruit and train their salespeople, and provide them with financial support and office facilities. Agency-building distribution systems can be ordinary agency distribution systems, multiple-line agencies, or salaried sales distribution systems.

Over the last several years, there have been many agency call centers that have surfaced in Canada. In this day and age, many of the older “career” style companies are getting away from that, due to compliance and liability issues. Hence, many are inclined to add a brokerage distribution system to their operation.

**Some Agency /Career System Terminology:**

**Agency system**

A distribution system in which insurance companies use their own commissioned agents to sell and deliver insurance policies.

The agency system was the most common system for distributing individual life insurance products and could have included the branch office distribution system and the general agency distribution system. Years ago, it was also called the ordinary agency system.

**Agent**

A party who is authorized by another party, the principal, to act on the principal’s behalf in contractual dealings with third parties. Called a mandatary in Quebec.
Agency relationship
In law, the relationship between two parties by which one party, the agent, is authorized to perform certain acts on behalf of the other party, the principal.

Captive agent
An insurance agent who is under contract to only one insurer and who is not permitted to sell the products of other insurers. Also known as an exclusive agent. This form or distribution is in contrast with the broker.

Career agent
A licensed insurance salesperson that is under contract with at least one insurance company. A career agent in some cases is considered to be an independent contractor and not an employee of the insurance company.

2. Brokerage System or Managing General Agency (MGA’s)
Some companies do not have their own agents, but sell only through a Brokerage network. Most companies with their own agents’ will still broker their products to “non-company” agents. Today’s MGA’s must find a value added reason for producers to continue to place business with them, and technology may (finally) be the answer. Full service offerings are now available that promise to reduce the work of both the MGA and the Brokers, and which will dramatically increase communications thus leading to more commissions for both the MGA and the Broker.

Some Brokerage or MGA Terminology:
Broker
A broker can be:
A. An insurance salesperson agent who sells insurance products for more than one insurance company.
B. For a career agent, to submit insurance applications to companies other than the agent's own company.
**Brokerage distribution system**
A distribution system that relies on commissioned agents, called brokers, who sell the products of more than one insurance company.

**General agency system**
A type of ordinary agency insurance distribution system wherein general agents establish and maintain field sales offices for an insurance company.

**General agent (GA)**
An independent businessperson who is under contract to an insurance company and whose primary function is to build and manage a field office of full-time career agents focused on distributing the products of a single company within a defined territory.

**Managing general agent (MGA)**
An independent contractor who is authorized to appoint brokers and GA's on a company's behalf and who may represent more than one company.

**Independent life brokers**
Licensed brokers who operate independently and specialize in selling particular types of products or in meeting the business coverage or estate planning needs of certain target markets.

3. **Multiple Distribution systems**
Canadians want a choice with easier access on how to purchase their financial products.

A major restructuring of the distribution systems across Canada has expanded distribution, improved service and made it easier for customers and advisors to do business with many Canadian Life Insurance companies.
SO THEN WHAT IS LIFE, DISABILITY & HEALTH INSURANCE?

**Life Insurance**
Life Insurance is a contract between you and a Life Insurer that specifies that the insurer will provide a certain sum or periodic income to your designated beneficiary.

The risk management involved with life insurance would:
- Replace income and eliminate debt.
- Pay final expenses.
- Provide buys out funds to purchase a deceased’s business interests.

**Disability Insurance**
Disability Insurance will be looked at in more detail in a later course.

Disability Insurance is provided by:
- Government Programs.
- Individual Contracts, Employer and Associations Group Insurance.

**Health Insurance**
Again, Health Insurance will be looked at in another course.

All provinces in Canada provide some form of medical coverage. These plans operate on two levels, one providing hospital care and the other medical care. These public plans can be augmented by a group benefit known as extended health care.

**TAXATION AND INSURANCE PREMIUMS IN GENERAL**

The General Rules:
- If the premium is paid out of pre-tax income, the proceeds are taxable.
- If the premium is paid out of after-tax income, the proceeds are tax-free.
- Benefits received through a private health insurance policy are not considered taxable income, regardless of who paid the premium.
LET’S TAKE A LOOK AT LIFE INSURANCE IN MORE DETAIL

The first application of Risk Transfer through insurance that we will address is the risk of death. Death always involves a loss, but in its financial sense, a loss due to death is measured in terms of incomplete financial goals and objectives.

How Do You Determine Any Potential Financial Loss Due to Death?

Some of the financial needs that may be created by a death are as follows:

- Final personal expenses – final medical expenses, funeral, burial, etc.
- Estate / death expenses – estate settlement costs to include federal and state estate taxes, probate, legal, accounting, appraisal fees, etc.
- Family income – support for surviving spouse and dependent children
- Additional expenses – necessary additional household services, childcare, etc.
- Liquidation of debts – payoff of mortgage, auto loan, credit cards educational loans, etc.
- Special financial needs – care of aging parents, special needs child, or other family member
- Liquidity – emergency fund; necessary immediate cash flow
- Bequests – church, school, family members, friends employees, charities
- Funding of established financial goals – completing college funding; purchase of second home, pay off the mortgage, etc.

There may also be additional financial needs of a business nature such as funding the transfer of an existing business through; or protecting a business from the loss of an owner/key-employee.
Calculating Life Insurance Needs

How Much Life Insurance Should An Individual Buy?

There are many formulas used in the calculation of life insurance need. The most meaningful methods consider both financial needs created at death and what available resources exist to address these financial needs. You should also remember that your needs will vary at different stages during your life.

The first step is to establish the dollar value of the needs. Some of these may be expressed as lump sums; others as cash flow. The next step is to identify what available resources may be used to eliminate or reduce the financial shortfall. These resources will vary greatly from family to family, but may include:

- Other sources of income from family members
- Survivor benefits (Social Security, employer-sponsored plans, etc.)
- Assets that may be easily liquidated and used to meet the established needs

Once available resources are applied against the identified needs, the amount of life insurance needed can be calculated.

Once the amount of life insurance needed is determined, the next decision is what kind to purchase. We will look at types of insurance later in the course.

The bottom Line... three good reasons to buy Life Insurance

1) Protection in the event of death – used to take care of any debt etc.
2) Providing a continuous flow of income for dependent families.
3) The growth of a worthwhile asset that will be returned to the policyholder in the event of long life. In addition to the actual sale of Life Insurance, the Agent became responsible for a number of other duties.
Today, most Agents/Brokers/Advisors find themselves involved with some or all of the following as they speak to their clients and prospects about insurance.

1. To spread the word of the necessity of Life Insurance.
2. To create the image of the need for insurance.
3. To help in the creation of new product.
4. To provide service in addition to sales.
5. The Agent or Broker becomes the conduit for large scale premium
7. To provide for lifetime security for the family.

People buy Life Insurance primarily because a Life Underwriter convinces them that they need it, and in addition prompts them to the periodic review of their needs, which reinforces their buying decision, and the review is largely the duty of the agent to arrange and pursue.

Life Insurance Agents provide the client with the following knowledge:

1) How to protect the family against Loss of Income at the income producers’ death.
2) How to protect and safeguard their business interest.
3) How to create estates, diminish worries, protect against taxes, provide for settlement costs and assist in transmits and the liquidation of estates.
4) How to provide future security through guaranteed cash values of life incomes.

INSURANCE MARKETING REQUIREMENTS for THE 21ST CENTURY

Before sales comes knowledge. This knowledge must encompass product, prospecting, needs analysis and sales skills.
A Broker or Agent requires the following attributes to be truly effective:

1) Product knowledge and its' uses.
2) Knowledge and skill in recognizing needs for the product.
3) Knowledge and skill in prospecting for people with these needs.
4) Knowledge and skill in the techniques of selling.
5) Service and follow-up.
6) An ability to integrate all these factors into a concentrated effort that produces sales.

The old key to success is still valid - Plan Your Work; and Work Your Plan!

Product knowledge is freely available from:

- Head Office, company literature or product providers.
- Contract and rate books.
- Underwriting knowledge is found in Company Literature and application requirement.

Prospecting and needs analysis are both linked together, since the ability to define needs is necessary to qualify prospects. We need to recognize:

a) The economic needs that life insurance can fulfill.
b) How life insurance can satisfy any needs, and
c) Which of these needs our prospects have?

Our approach, regardless of market, should follow a similar pattern:

a) Pre-approach mailing, telephone approach or face to face.
b) Establishing the general problem.
c) Identifying a specific problem(s).
d) Determine the different solutions.
e) Presenting Life Insurance as the one solution that fits best.
f) Dealing with objections.
g) Closing the sale.
People buy life insurance products because they realize that all people grow old and/or die and in any event their earning power is destroyed and a new source of income – dollars must be ready to take its place.

Life insurance is always paid for either before death by the policy owner or after death by the family survivors through loss of economic security and life style. In the selling of Insurance the preceding is mandatory for success, but the retaining of the client and their Insurance demands a thorough and comprehensive follow through of service.

QUESTIONS THAT THE AGENT, BROKER or ADVISOR SHOULD ASK BEFORE MAKING THE RECOMMENDATION FOR THE CLIENT OR PROSPECT

• Has debt load increased or decreased?
• Will debts be called in the event of death or have you insured the principal?
• Has the value of your assets increased or decreased?
• Has number of dependents changed?
• Is a beneficiary change required?
• Any health change in family members?

The Needs Assessment is the BIGGEST Part of the Planning Process
Although another course is offered that will go into much more detail in assessing your clients or prospects required insurance coverage, it is important that we touch on a part of that process in this course.

The planning of your security program involves a need assessment should the primary income provider die. Insurance agents have been trained for years; on how to develop needs based insurance programs.

There are many factors to consider when deciding how much life insurance your clients and prospects need.
Marital status, their income, their dependents and any other major expenses are just a few areas to consider. By weighing these and other factors, you can get fairly comfortable with their life insurance decision.

The problem to consider is that every person's situation is different, and although their financial situation may look the same as another individual, their needs are different.

Calculating how much life insurance your clients and prospects need shouldn't be a guessing game. You can assess their needs -- and the needs of their loved ones, and then make a calculated assessment.

A lot of insurance advice seems to be based on the clients/prospects marital status to determine their insurance needs. That's not exactly the issue. The most important factor is if they have any dependent.

**So here is what must be looked at when making any life insurance suggestions:**

- The kind of lifestyle the client or prospect would want to provide for their family.
- The client’s non-working spouse, who wouldn’t have an income if they died.
- Their working spouse, who would "retire" to raise their children if a death occurred.
- Any other sources of household income (such as a second monthly income).
- Any debts that the client/prospect would want paid off (such as a mortgage, car loan or credit card).
- Their family’s post secondary expenses.
- Any special needs, such as a handicapped child or a child who will never be self-supporting.
- The clients/prospects parents, who may eventually become financially dependent on the client. There could be a “sandwich generation” situation.
Here are some other major needs assessment factors to consider:

Even if your client or prospect is wealthy and they think that they might not need coverage, they should think again. The mere fact that they are wealthy has created the need for Legacy or Estate Planning to keep intact what they have worked to create. A life insurance policy will solve this problem.

Childless now, but what about the future?

If the clients do not have any children now, but they plan to have a family in the future, their insurance needs could vary from almost nothing to needing heavy coverage.

Divorced people have special insurance needs. If any of your clients or prospects falls into that category, they had better dig out their divorce agreement. It may stipulate that they have to keep a certain amount of life insurance in force for their ex-spouse or to pay a part of their children's education.

Single people are often told that they don’t need insurance, or that the small policy that comes with their work benefits is enough. In many cases, that’s absolutely right. If they lead a simple life with no mortgage and no significant other, a life insurance policy may just be an unnecessary expense. There are certain instances where they may need insurance.

If one of these scenarios applies to your client or prospect, they should start thinking about life insurance:

- They have a mortgage that is more than the value of their house.
- A relative has co-signed on their mortgage; having it paid off immediately at death means they do not have to make monthly payments until the home is sold, were they to die with not enough insurance coverage.
- They have a friend or relative to whom they want to leave money.
• They have bought a house with their live-in partner and they have an agreement that each person's share of the mortgage is to be paid off upon his or her death.

• Their parents won’t be able to manage financially if the client or prospect is not around.

• They want to leave money to a charity or other nonprofit organization.

From the previous examples we can see that Needs Assessments are based on determining two main requirements:

2. Income Needs.

A Needs Assessment generally includes the following:

• How much after-tax income is required?

• Adjust this income amount by the CPP benefits for survivors.

• Determine the coverage tax rate that will apply to monies invested to provide income.

• Determine how many years income is required (dependency period and/or life income).

• Determine rate of inflation.

• Determine pre-tax income to be received.

• Calculate unpaid mortgage balance.

• Estimate final expenses.

• Review existing amount of life insurance.

• Using software program or time value of money calculation, determine what additional amount is required.

Exposure to risk cannot be completely eliminated, but the effects caused by loss can be greatly reduced to protect the dependants and the lifestyle wishes of your clients and prospects.
THE EVOLUTION OF LIFE INSURANCE

Due to lapsed policies, excess premium is injected in long-term investments and so early termination may result in a reduced value to the Company, which is passed onto the policyholder. Life Insurance started out as a method to provide some protection for a specific insured for a specific period. From this simple beginning has evolved a complex product with many guarantees and values.

The factors that contribute to the present day insurance products are:

1) Premium Setting

Let’s look at the 35 year old guy who pays $25 per month for a policy with a $200,000 death benefit. How can the insurance company make any money if the guy dies in the first year? The correct answer is that they can’t make any money off that guy. But let’s put 20,000 of those guys together and bring in $500,000 each month or $6,000,000 for the year. The insurance company now has some money to invest and has the opportunity to make those dollars grow and earn interest.

For our purpose, let’s assume the Insurance Company invested very well and achieved a 10% return, or $600,000. They now have 20,000 policyowners so any expenses that they have can be spread over 20,000 accounts. Let’s keep it simple and say that they have building rental, staff costs and selling expenses, including commissions, totaling $2,000,000 this year. From the mortality tables they can also determine that five of those 20,000 35-year old guys will pass away this year and the death benefits to be paid-out are expected to be $1,000,000. This is obviously an extremely simplified explanation but it does identify the three key components that go into making-up an insurance premium.

Components of a Life Insurance Premium

- Mortality Tables – over 250 years of experience
- Operating Expenses
- Interest Earning Projections
If you assume the insurance company has thousands, if not hundreds of thousands, of these and other types of policies from people of all ages, the numbers become mind boggling. You start putting term insurance policies with whole life insurance and variable products into the account and you have to wonder how they keep track of it all. Expenses and mortality costs all come out of the insurance company’s general account. In some policies, the interest earned is paid into the general account.

For purposes of insurance terminology:
Gross premiums = mortality + expenses – interest
Net premiums = mortality – interest

Keep in mind that monthly payments are more expensive than annual payments simply because the insurance company must deal with the paperwork each month and those added costs are passed on to the policyowner. Annual premium payments buy more insurance for the same dollars because of the paperwork cost reduction and the fact the insurance company can invest the money for the entire year rather than only one month.

2) **Premiums are adjusted to reflect:**
   a) Gender Basis
   b) Age
   c) Standard or Substandard

**Standard Risk**
A person, who according to a company's underwriting standards, is entitled to insurance protection without extra rating or special restrictions.

**Sub-Standard Risk**
Person who is considered an under-average or impaired insurance risk because of physical condition, family or personal history of disease, occupation, residence in unhealthy climate or dangerous habits. Today, lifestyle issues such as smoking vs. non-smoking homes can affect the class of risk that is issued.
3) **Reserves Vs Cash Surrender Values:**
The legal reserve known, as The Cash Surrender Value is an ever-increasing fund held in trust by the Insurance Company to the credit of the policy holder and is available upon cancellation of the policy or non-payment of premiums. In later years the two terms result in identical values but in the early years the CSV may be less than the Government legislated reserve because of:

- Cost of issue and underwriting
- Adverse selection

**An Insurance Policy Can Be Issued:**

1. **Non-Participating Policy (No Dividends Paid)**
Life Insurance policy whose policyholders do not receive dividends, because they are not participants in the interest, dividends, and Capital gains earned by the insurer on premiums paid.

2. **Participating Policy (Pays Dividends)**
Life Insurance that pays dividends to policyholders depending on the company’s success as provided by few claims and profitable underwritings and investments. It is the annual payout of equitable share of the surplus account called dividends.

**Dividends are created by additional premiums to reflect:**

- If mortality and morbidity costs are higher than expected
- Lower interest earnings than projected
- Higher operating costs than anticipated.

Dividends are not guaranteed and can be increased or decreased at the discretion of the Insurance Company at any time.
Dividends can be used for the following:

1. Taken in cash
2. Accumulated at interest
3. Used to reduce future premiums
4. Used to by paid-up additions
5. 5th Dividend Option: Special 1 Year Term purchased equal to CSV.
6. 1 Year Term additions
7. Paid into an Investment Fund
8. Used to by enhanced coverage – (a form of 6)
9. Used for premium offset – (combination of 3 & 4)

4) Settlement Options:
Most life insurance policies provide several options in addition to the beneficiary receiving a single lump sum check, or a checkbook instead of a check. Most provide the beneficiary of a life insurance policy with the right to receive a monthly payment for the rest of your life, or a payment to you and another person for life. Insurance companies offer customers numerous such alternatives because some insured's and beneficiaries prefer monthly payments so that they do not have to manage a large lump sum settlement, or they want the money to last for awhile.

*In the event of Death or Maturity as well as early termination, the policy contains Settlement Options for the proceeds. Some examples are:*

a) Payment of cash
b) Left on deposit and pays out interest
c) Fixed income payment (Term Certain Annuity)
d) Fixed period payment (Term Certain Annuity)
e) Life time income (Life Annuity with or without guarantees)
f) Joint and Last Survivor Income (A form of Life Annuity)
DIFFERENT TYPES OF INSURANCE POLICIES

What Kind of Life Insurance Should I Purchase?

There are several types of life insurance; each with numerous variations. The type of coverage that is best for your clients and prospects depends on a number of factors.

First, a brief familiarity with the basic types will be helpful:

TERM INSURANCE

Term is insurance that is purchased for a certain period of time (its “term”). During that term, premiums are paid, and a death benefit will be received, if death occurs. There is no cash value build-up. Premiums on term plans are considerably less expensive than with other plans.

At the end of the term, the insured will be faced with one of several choices, depending on the type of term policy purchased. If the need for insurance still exists, the insured will have to apply to purchase a new term policy; generally requiring evidence of insurability (good health); or may be allowed to continue with the existing plan, but at a considerably higher premium.

Term plans are sometimes compared to renting a home. During the time premiums is being paid (“rent”); the insured receives the benefit of coverage.

Once the premium period has ceased, the insured must “move” or pay higher “rent”. There is no “equity” (cash value).

Term Insurance comes in two types:

1. Specified period of time (Term of Protection)

   Protection and Premiums are payable for a certain stated period of time and then expires unless converted to a cash value policy – e.g. 1, 5, 10, 15, 20 or 25 year term.
2. **Renewable and Convertible Term.**
Protection and Premiums payable for a stated number of years, e.g. Age 75 or 90, and premiums start out quite low and increase at the end of every 5th, 10th, 15th, or 20th year, based on the age attained. Policy is guaranteed to renew and is convertible to a Cash Value policy at anytime, subject to a specified maximum age.

To conclude, Term Insurance has many uses, but due to its’ protection only and limited duration is generally considered for short-term obligations or a less expensive alternative until a better solution can be afforded.

**The most common types of term insurance are:**

**Annual Renewable Term/Regular Term**
Death benefit remains level during the term; premiums increase with age, usually annually. Protection & Premium are payable for a pre-determined length of time by the contract.

**Decreasing /Reducing Term**
Death benefit decreases over the term purchased, with premiums remaining level. At the end of the term, the policy terminates, with no further benefits.

This type policy has historically been used as mortgage cancellation insurance, with the death benefit and term coinciding with the mortgage balance and term.

An example of this is the protection reducing at a predetermined rate (e.g. 5% per year) while the premiums remain level.

**Level/Straight Term**
Death benefit is level during the term selected (such as 5 years, 10 years, 20 years, etc.). Premiums are level during this period and are usually guaranteed not to increase during the term selected.
Family Income Term
Specially designed decreasing term policy that pays a monthly income rather than a lump sum, for a pre-determined number of years such as 10, 15, 20, 25 years or a given age. Policy guaranteed a certain unit per $1,000 insured such as $10, $15, or $20.

The commuted value is the amount of lump sum available at any given duration required to provide the monthly payment for the number of years remaining in the contract. If sold as a rider it is called a Family Income Rider.

Term Riders
Any term plan may be sold as an individual policy or attached to any other plan as a rider.

e.g. - Base Policy: 250,000 Term to Age 100 or Whole Life
Term Rider: 300,000 20 Year Term.

Preliminary Term (Interim Term)
Low premium protection of a limited duration (e.g. 1 month to 5 years in duration) that guarantees the face amount and protects insurability and automatically converts to a predetermined type of contract for the same face amount. Used to get issue of policy and delay start of larger premium payments until they can be afforded more easily.

Some other plan features to consider are:
Renewability - Policy may or may not be renewable (able to be continued) at the end of its original term without having to provide evidence of insurability.

Convertibility - Policy may or may not be eligible for conversion (exchange) for one of the permanent plans offered by the insuring company.
Re-Entry - A term policy under which the company may renew the policy at a lower premium rate than would otherwise apply, provided that at the time of renewal, the policy holder applies and furnishes evidence of insurability (e.g. medical exam, etc) satisfactory to the company. The ability to apply for lower rates may or may not be guaranteed in the contract.

Advantages of term insurance
- Policy is considerably less expensive than permanent cash value plans.
- Policies can be structured to meet specific dollar and timing needs (i.e. A 10 year level term plan to match the maturity of a bank loan).

Disadvantages of term insurance
- Policy is only cost effective during “term” of coverage. If need extends beyond coverage period, premiums can become prohibitively expensive.
- There is no cash value or “equity” in the policy.

PERMANENT INSURANCE
Permanent insurance, unlike term, is intended for long term needs. Premiums are generally level (although they may not be guaranteed), and the policy accumulates cash value with more flexibility than term insurance products.

WHOLE LIFE
This is the oldest form of permanent/cash value life insurance. Whole life insurance covers you for your entire life, not just for a specific period such as term insurance. Your death benefit and premium in most cases will remain the same. Whole life insurance also builds cash value, which is a return on a portion of your premiums that the insurance company invests. Your cash value is tax-deferred until you withdraw it and you can borrow against it. It features a guaranteed premium; a guaranteed cash value; and a guaranteed death benefit. The cash value earns a minimum guaranteed rate of return, and may also receive dividends or additional interest.
Are there choices within whole life insurance?

Yes, the most common choices include traditional, interest-sensitive, and single-premium whole life. Traditional gives you a guaranteed minimum rate of return on your cash value portion. Interest-sensitive gives a variable rate on your cash value portion, similar to an adjustable rate mortgage. With interest-sensitive whole life you can have more flexibility with your policy such as increasing your death benefit without raising your premiums depending on the economy and the rate of return on your cash value portion.

Single-premium is for someone who has a large sum of money and would like to purchase a policy up front. Like other whole life options, single-premium whole life accrues cash value and has the same tax shelter on returns.

What are the benefits of choosing whole life over other types of life insurance?

Unlike term life insurance, a portion of your premium money goes toward your cash value which in turn could pay off your entire policy only after a few years. Also, your premium will remain constant during the time you are covered unless you choose otherwise. And, unless you make a change to your policy, you have lifelong coverage with no future medical exams. Whole life is also a good choice because of the tax savings.

Should your clients and prospects purchase a whole life policy for an investment?

The rate of return on a whole life insurance policy is very low compared to other investments, even with the tax savings factored in. Most investment professionals would agree that life insurance should not be used solely as an investment tool. Your clients and prospects should judge policy choices on the protection and not the rate of return. But, if they are in need of life insurance, the tax benefits and cash value is an added bonus when purchasing protection for their loved ones.
Whole Life overview:
- Insurance protection for life
- Level premium payable for life – (payments may cease
- As early as age 90)
- Provides for payment in full of the Cash Surrender
- Value at Age 100, in effect the policy becomes and
- Endowment at Age 100
- Increasing Cash Value (Reserves) that provide for the
- Previously mentioned policy growth and cash values.

Types of Whole Life plans

Limited Payment Life
This policy is the same as a straight whole life plan except the premium payment period is reduced to a shorter period. Since the same amount of income is required to provide the benefits, this results in a higher annual premium resulting in higher early cash surrender values (CSV).

Endowment
A type of life insurance that may produce profits. An endowment policy will run for a fixed number of years during which it accumulates a cash value and can provide a savings plan for a retirement fund. The cash surrender value will be equal to the sum insured at maturity.

It is best to take out endowment insurance when the clients and prospects are still economically active as it provides the necessary insurance protection.

A profile of endowment insurance:
Following the expiry of the insurance period the insurance company will pay the sum assured directly to the insured party either as a lump sum or in the form of a regular pension.
In the event of the death of the insured party during the period of the policy, the agreed sum assured is paid out to the beneficiary or beneficiaries.

The program offers the client or prospect the possibility of increasing the sum assured and their premiums to keep pace with the rate of inflation, assuming that their health has not changed drastically.

**Advantages of Whole Life Insurance**

- Policy is a permanent plan, so future insurability is guaranteed.
- Policy costs, and therefore, premiums are guaranteed
- Death benefit is guaranteed
- Minimum cash value is guaranteed.

**Disadvantages of Whole Life Insurance**

- There is little flexibility, with respect to premium and death benefit.
- Cash value accumulation may be at returns lower than other financial investment products.
- It provides less death benefit per premium dollar than other forms of insurance.
- Policy cash values may be accessible only by loan or surrender of policy.

**Interest Rate Sensitive and Adjustable Life Insurance generally falls into two different categories:**

1. **ADJUSTABLE LIFE (NEW MONEY LIFE INSURANCE)**

   Although not too much of this product is still marketed in Canada today, due to the rapid change in interest rates over the past decade or so, it is important to realize that some of your clients may still have some in their portfolios.

   With this type of insurance policy, the face amount and premiums are guaranteed for a short term period e.g. 3 or 5 years.
Since this is a cash flow (premiums) product the interest rates are examined at the end of that period and a guaranteed rate is determined for the next term of years.

Either the premium or level of protection may be adjusted to reflect the increase of interest levels.

2. UNIVERSAL LIFE (UL)
These policies contain two components; insurance costs (which increase with the age of the insured) and the cash value component. Interest is paid on the cash value, with returns being similar to current money market returns. Death benefit may be structured to be level or may increase as cash values increase. All aspects of coverage (pure insurance cost; policy administrative charges; premiums; interest credited to cash accumulation, etc.) are detailed separately and disclosed on an annual policy statement.

Universal Life (UL) is known as the most flexible type of life insurance. Premiums are flexible, your clients and prospects can have a level or variable face amount, they can choose the investments from a menu of options for the cash value portion of the policy, and they can borrow taking a policy loan if the need arises.

As long as they pay enough in premium to keep insurance part of the policy in force, they can vary the frequency and amount of their premium payments and, as a result, vary the death benefit. For example, this flexibility lets them start with a high life insurance value if they need it to cover a mortgage. They can then decide to decrease the face value and allow the cash value to grow more quickly as their mortgage balance decreases.

This may sound like a good deal, but makes sense in only a few specific financial planning situations. Most times it makes more sense to buy term life and invest the difference.
Here are examples when UL might make a good choice:

- The clients have a health condition and cannot qualify for term life. The qualifications for term life are the most difficult to meet. Sometimes they can qualify for UL when term life is not an option.

- They have maxed out on all their tax shelter options - such as RRSPs or RRIFs. They are looking for a vehicle to grow their money tax free and don't want to invest the money on their own. This option may make very good sense for the purposes of estate planning, but they should make this determination while working with a good financial planner who is looking at the entire financial picture.

- They then can access the cash value portion of the policy for university expenses, a second home, travel or other financial needs. They can withdraw these funds tax-free up to the cost basis as long as the policy is in force. Withdrawals will reduce the cash value and death benefit proceeds.

Flexible Protection
Universal life products gives the client or prospect the flexibility to choose the amount of protection that best suits their family or business. It allows them to increase or decrease coverage as insurance needs change. Increased coverage may be subject to underwriting requirements.

They may not decrease their coverage below the required minimum. A decrease may result in a surrender charge being applied against the policy's cash value.

Flexible Premiums
With universal life insurance, you control the amount and frequency of payments. Looking towards the future? You have the option to increase the premium or make lump sum contributions, subject to limits as specified in the policy. The extra dollars grow tax-deferred, and may increase the cash and death benefit values.
On the other hand, in a temporary cash crunch, you can pay less than the scheduled premium and let the policy's accumulated cash value pay the remainder of the monthly charges.

**Flexible Design**
Universal life products can be customized with innovative policy features to fit any lifestyle. Universal life policy riders can protect the client's spouse and children, protect their ability to pay premiums during disability, and increase the benefit to their family if they should die accidentally.

**Is the client’s money guaranteed?**
The client will usually get a minimum interest guarantee from the insurance company, while the actual performance of the cash value fund is based on insurance company investments.

In exchange for taking the risk of basing your return on investments, the premiums can be lower than those of a whole life policy. There is the risk of possibly needing to add more than originally expected to cover the life insurance premiums to keep the policy in force if the investments do not do well. Universal can be an economical alternative to traditional whole life and may even cost less.

**Universal Life overview**
- Flexible protection can be of a level or decreasing term nature, as well as whole life.
- Flexible premium levels and periods allows for premium holidays and premium offset.
- Cash value is invested in a variety of ways or interest is credited to the CSV account with an external yardstick measurement e.g. Rate not less than 5 year Canadian Average Bond Fund.
- Flexible withdrawals, loans and surrender.
Advantages of Universal Life

- Policy is a permanent plan, so future insurability is guaranteed.
- Premiums are generally lower than with some other permanent plans.
- Policy is very flexible, allowing increases or decreases in death benefit and premium.
- Policy cash values may be accessed by loan or withdrawal.
- Lump sum deposits may be made to the policy (within certain limitations).
- Detailed policy statement disclosure makes it easier to understand actual policy costs and benefits.

Disadvantages of Universal Life

- Policy costs may vary throughout the life of the policy (pure insurance and administrative costs) which can cause premiums and/or death benefit to fluctuate.
- Cash value accumulation will generally not be significant at money-market-equivalent rates.

As you can see from the above disadvantages, there are a couple of major disadvantages. The one that we would like to go into more detail is in regards to the fees and lack of investment options. The insurance fees can be considerable and do not make sense unless their truly is a need for the insurance.

Fees that must be considered are any annual mortality and expense charge, the premium load (premium expense charge plus premium tax charge), sales load (if any), monthly administrative charge, monthly cost of insurance, and policy surrender charges for early withdrawal, if applicable. Any gains will be taxed when they are withdrawn.

The other big disadvantage is the lack of investment options for the cash value accumulation portion of the fund. The insurance company can significantly limits the mutual funds that can be chosen depending on the company the UL is placed with.
If there is a need to withdraw the funds, fees may also take a huge bite especially in the early years. Many universal life policies carry back-end surrender charges that are deducted from the balance in the fund. These fees start out high in the early years and slowly decrease until they finally disappear usually in the 15th or 20th policy year.

OTHER LIFE INSURANCE PRODUCTS

Annuities:
Annuities are investment vehicles that provide for an accumulation period, maturity date and an income period. It provides a blended payment of interest (earnings) and principle.

There are two main versions:
1) Fixed or Guaranteed Annuity
2) Variable Annuity

1. Fixed / Guaranteed Annuities are issued in two main types:
   Immediate Annuity
   A lump sum premium is paid and immediately the income produced, commences. The annuitant elects a payout option based on a monthly, quarterly, semi-annual or annual schedule.

   Deferred Annuity
   A lump sum premium may be paid or a periodic premium payment elected and is deposited for a number of years until the maturity of the contract e.g. Deferred Annuity purchased at Age 30 and matures at Age 65. At maturity the income period commences and payouts are identical to the immediate annuity schedule.
New Money Deferred Annuity (Interest-Rate Sensitive Annuity)
This variation on the Deferred Annuity theme is an annuity usually with a lump sum deposit that has a guaranteed interest rate for a short term period (e.g. 3 to 5 years).

At the end of the guarantee period, the contract renews the interest rate guarantee at whatever interest rate reflects the current competitive interest rates. (This is the Life Insurance Industries answer to GICs).

Death Benefit

Before maturity
The annuitant would receive return of premiums or the value of the accumulated fund, whichever is greater. Variable annuities contain a minimum guaranteed payout at death of maturity e.g. 75% of premium paid.

After maturity
Contract may contain minimum payment or lump sum guarantees.

Pay-out Options during Income Period
After the maturity date, the annuity has a choice of two main options. These payments are level and contain guarantees as to amount and/or duration.

The payment is a blend of capital and interest. Only the interest is taxed.

Life Income
This option provides a level payment that lasts for the life of the annuitant and then ceases. A Life Annuity however may contain payment guarantees.

The payments vary in length only to the extent of the company’s obligation to pay anything further to a beneficiary if the annuitant dies.
Life Income Options

- Lifetime, only.
- Lifetime, with years certain.
- Lifetime, with installment refund.
- Lifetime, with cash refund.
- Joint and last survivor.

Term Certain Annuities

Term certain annuities are contracts between insurance companies and investors. The insurance company receives a lump sum from the investor and, in return, guarantees to pay the investor a specified amount of money for a specified period of time, such as five or ten years.

Payments continue regardless if the annuitant lives as long as the guarantee or not. If death occurs, the payment continues to a beneficiary or the estate until the guarantee is fulfilled.

Objective

To provide investors with maximum monthly income over a certain period of time.

Suitability

Term certain annuities are best suited for conservative, income-oriented investors.

Features

Regular Income - Regular monthly, quarterly, semi-annual or annual income is paid on a systematic basis. Investors know exactly how much income they will receive and how long it will last.

Income Period - Term certain annuities can only provide an income for a certain and predetermined period of time.
Liquidity - Once a term certain annuity is purchased, it cannot be altered or ceased. The payments from the annuity must be continued as the contract originally stipulated until, when by contract provisions, the insurance company has met all its obligations and the policy is terminated.

2. Variable Annuities

A variable annuity contract provides a guaranteed number of payments in which the amounts of the payments vary in accordance with the current market value of the investment fund supporting the variable contract. Each contract is allocated a specific number of investment units, purchased by the deposit, which has been determined by formula.

Variable annuities allow a customer to save for the future on a tax-deferred basis and to select payout options that meet the customer’s need for income upon maturity, including lump sum payment or income for life or for a period of time.

Premiums paid on variable annuity contracts are invested in funds offered by the insurance company and third party providers, including bond and equity funds, and selected by a client based on the client’s preferred level of risk. The assets and liabilities related to this product are legally segregated for the benefit of particular policyholders in separate accounts of the insurance company (classified as investments for the account of policyholders).

Various riders are available on variable annuity contracts, providing guaranteed minimum death and/or maturity withdrawal or income benefits. The account value of the variable annuities reflects the performance of the funds.

The insurance company earns mortality and expense charges as well as various types of rider fees for providing various forms of guarantees and benefits, including guaranteed death and income benefits.
INSURED ANNUITIES FOR THE CLIENT WITH NON-REGISTERED MONEY

There are many creative things that can be done for clients who have non-registered assets. Often the more creative solutions involve using different products in tandem. The insured annuity (back-to-back annuity) is a prime example of this. It is important to ensure that the clients qualify for the life insurance first, before purchasing the annuity component.

The example below shows that if clients place their money in conventional GICs with an effective payout rate of 4%, the annual income will be $4,000, all of which will be taxable. At their tax rate this would create tax payable of $1,600 leaving $2,400 as net after-tax income.

Alternatively, if they purchase a joint life annuity combined with a joint, last-to-die life insurance policy, the net income changes very favourably, even after the premium for the insurance coverage is removed.

The concept is very straightforward. A joint life annuity is purchased so that a guaranteed income of $6,590 is payable on an annual basis for as long as either one is living.

In order to create the highest possible income, we have chosen an annuity with no guaranteed period. What this means is that at the second passing there is no benefit to their estate or to their heirs. This is why we have acquired a joint, second-to-die life insurance policy.

The annual premium is $1,344. At the second passing of our two clients, a tax-free benefit will be paid to named beneficiaries or the estate, thereby replacing the original capital.

The estate is in exactly the same position as if the GIC had been purchased. The major benefits are realized in the after-tax income that the clients will receive for as long as either one is alive.
Assumptions to illustrate this concept

- Male age 65 and a Female age 62 - (both non-smokers)
- Capital - $100,000
- GIC Rate – 4%
- Marginal Tax Rate – 40%

<table>
<thead>
<tr>
<th></th>
<th>GIC ($)</th>
<th>Single Life* Annuity ($)</th>
<th>Joint Life Annuity ($)</th>
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<tbody>
<tr>
<td>Annual Income</td>
<td>4,000</td>
<td>7,602</td>
<td>6,590</td>
</tr>
<tr>
<td>Taxable Portion</td>
<td>4,000</td>
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<td>2,508</td>
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<td>Tax at 40%</td>
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<td>Net Income From Taxable Portion</td>
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<td>1,505</td>
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<tr>
<td>Non-taxable Portion</td>
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<tr>
<td>Total After Tax</td>
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<tr>
<td>Annual Insurance Premium</td>
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<td>1,344</td>
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<tr>
<td>Total Net Annual</td>
<td>2,400</td>
<td>4,184</td>
<td>4,243</td>
</tr>
</tbody>
</table>

* This example is for a male age 65

Even after taking into account the insurance cost, they still have an after-tax income of $4,243. This is $1,843 more each year, on an after-tax basis, than current interest rates would provide from a bond or a GIC. This represents an increase in their spendable income of 76.8%. Stated another way, you would have to have a GIC or bond paying an interest rate of 7% to deliver the same net annual after-tax income as the annuity.

The illustration above used an insurance policy where premiums are payable to the second death, which is also when the benefit would be paid to the estate. Another option in this strategy is to investigate the use of insurance where the death benefit is still paid at the second passing, but the premium stops at the first death. The difference in premium would be $465 per year.
So if this were used the total insurance premium would be $1,809 per year instead of $1,344. But there would be no more premiums payable at the time the first death occurred. This means that the net income to the survivor would be $5,587 for the rest of his/her life. This is $3,187 or 132.8% higher than the after-tax income that would be paid by the GIC. A GIC or bond would need a rate of 9.25% to create the same after-tax return. And, the $100,000 comes back to the estate tax-free when the survivor passes away.

Ultimately, your clients will have received more after-tax income from the insured annuity than they would from the GIC. At the second passing, the $100,000 originally used is returned, tax-free, from the insurance and in this way the capital is preserved. And if the insurance proceeds are paid to named beneficiaries, rather than to the estate, the money will be exempt from probate.

The one trade-off in this whole arrangement is that your clients will not have access to the principal sum if it has been used to purchase an annuity. However, this should not be an issue if the prime focus is to satisfy the guaranteed investment and income objectives stated earlier. It is also to be noted that this is a concept that may apply to a portion of their non-registered holdings and not to the entire amount. Again, total planning is the key.

There is however sufficient merit in the analysis of the numbers to consider this as an option for part of your client’s income strategy. This is a perfect addition of tax-effective income where your clients have already created fully taxable income up to the first federal tax bracket.

**IMPAIRED HEALTH ANNUITIES**

Some insurance companies will provide a higher than normal income for individuals with seriously impaired health, based on the assumption that life expectancy is shorter than normal. To establish the degree of impairment, a medical certificate or examination is required at the time the annuity is applied for.
PRESCRIBED ANNUITIES

A standard annuity payment, for an annuity issued **before November 13, 1981** contains in the early payments a far higher interest component than in later payments in the contract.

**After December 1982**, all annuity contracts (unless designated to be a standard contract) were “Prescribed Annuity Contracts”.

The annuity payments in PACs contain a level interest component, because the capital (deposit) element of the annuity is apportioned evenly within the expected payment period. A prescribed annuity must contain certain provisions.

*To qualify as a prescribed annuity, the contract must satisfy all of the following conditions:*

- The payee must be the owner and an individual (and may be a spouse, trust or a testamentary trust).
- The annuity must be non-commutable.
- Payments must have started, i.e. prescribed status cannot apply during the deferred period.
- Payments must be level but may reduce on the first death under a Joint Life Last Survivor Annuity.
- A joint annuitant must be the primary annuitant’s spouse, brother or sister.
- A guaranteed or certain period cannot extend beyond the owner’s 91st birthday (or joint annuitant’s 91st birthday if later).

Prescribed status will apply automatically, if the above conditions are met, unless the owner advises the Company to the contrary.

The taxable portion for a prescribed annuity depends on the age(s), plan type, payment frequency and rate basis. To calculate the taxable portion, you need to know the annual income, the adjusted cost base, and the expectancy.
Annual Income (A.I.)
This is the total amount that will be received by the annuitant in a full calendar year of payments. For example, it equals 12 times the payment for a monthly case.

Adjusted Cost Base (A.C.B.)
For new issues, and any contracts which have not been taxed since issue (for instance, an annuity deferred two years where tax was on a triennial basis), the A.C.B. is the single premium.

For other cases, such as Settlement Option annuities and policies changing to prescribed after being taxed as non-prescribed, the A.C.B. takes into account the original premium paid, any previously reported taxable amounts, as well as other minor items. For these cases, the A.C.B. is calculated by Head Office.

Expectancy (E)
For an Annuity Certain, expectancy is simply the certain period in years. For Life Annuity, expectancy depends on the age and sex of the annuitant. Age is calculated as year of first payment minus year of birth. The life expectancy for an impaired annuity is determined without recognition of the annuitant’s shorter life expectancy resulting from the impairment.

For an annuity which suggests the plan type be prescribed at issue, the taxable portion will appear on the quotation.

However, the fact that a taxable portion is printed is not a guarantee that the annuity can be prescribed as it may fail one of the other tests, such as the annuitant not being the owner. The taxable portion does not appear for Settlement option cases since the adjusted cost base does not equal the premium.
NON-PRESCRIBED ANNUITIES
Under a non-prescribed annuity, a policy owner may be required to include in taxable income an amount greater than the annuity income received in a given year. This generally occurs where annuity payments are expected to be made for a long period of time or where payments are guaranteed beyond the annuitant’s 90th birthday.

Deferred Annuities are on an annual taxation basis during the deferred period. In the year annuity payments start, any untaxed gain accrued since the last taxation year will be spread over the annuity payout period.

ARE ANNUITIES FOR YOUR CLIENTS & PROSPECTS?
Annuities can represent an important component in any retirement strategy, offering two powerful benefits:

Security
Regular income of a pre-determined amount that is guaranteed for life

Convenience
The freedom of no longer having to manage your investments. This transfers all of the investment risk from you to the insurance company.

Consider these factors when speaking to your clients and prospects:
• Their age
• Their need for a regular flow of retirement income
• Their need for occasional access to additional capital
• Their ability and interest in actively managing your investments
• Their family and estate planning considerations
• Their concern over inflation

For many individuals, the decision to purchase an annuity can change over time as their personal situation changes, so keep this option in mind for later on.
VARIABLE CONTRACTS (aka SEGREGATED FUNDS)

Variable contracts, also known as segregated funds, are contracts between insurance companies and investors. They work similar to mutual funds and have added features, which insure and guarantee deposits at maturity and death.

This type of contract has a reserve, or a part thereof, that varies in value depending on the market gains or losses of a specified group of assets held in a segregate fund.

They can also include a provision in a Life Insurance Contract under which policy dividends are deposited in such a fund.

Variable Contacts are considered to be Life Insurance Contracts (governed by the Life Insurance Act) because they contain a guarantee of not less than 75% of the gross premium will be returned at death or maturity.

A Variable Contact Contains Two Elements

1. An Insurance element – protection in the event of death or an Annuity Option in the event of survival.
2. The reserve varies in value depending on the performance of the segregated fund. This is known as the equity element.

Two Types of Variable Contracts

1. Contracts With No Life Insurance:

Contracts contain no Life Insurance, but provide guaranteed annuity options. Premiums, after deductions, are invested in the segregated fund.

Surrender Value

- The value of all units credited to the policy.
- Partial surrender possible.
Guaranteed Value
Value of the units held, but not less than 75% of Gross Premiums paid at death or maturity.

Death Benefit
Before maturity – 75% of Gross Premium, or the value of the units held, whichever is greater. After maturity contract payment guarantees.

Contracts with Life Insurance
Life Insurance may be Level or Decreasing Term as well as Whole Life.

Surrender Value
• C.S.V. and accumulated dividends of the whole life portion, and Value of the units held.
• Partial surrender possible.

Guaranteed Value
• Cash Surrender Value of the Whole Life Portion and the accumulated dividends plus the value of the units, but not less than 75% of gross premium paid into the equity element if at maturity.
• Life Insurance portion may be continued after surrender of units of equity element.

Death Benefit
• Face value of Life Insurance or
• Value of units credited to equity element, but not less than 75% of gross premium paid.

Note: Dividends may be invested in segregated fund.
Contract Charges

- Front end load
- No load
- Redemption charge

Primary rule in the sale of variable contracts is making sure that you provide full disclosure.

Taxation

Sum Insured Proceeds at death are not taxable.

Objective for this type of contract

To provide investors with the opportunity for market appreciation and the accumulation of wealth for retirement.

Suitability for this type of contract

Segregated funds are suited for individuals who are interested in long-term growth for purposes such as retirement planning. Self-employed individuals and the mature market are also ideal candidates for segregated funds because of the potential creditor protection and estate planning advantages.

A REVIEW OF THE FEATURES OF VARIABLE CONTRACTS

Separate Account

Segregated Funds are not part of the general assets of the insurance companies. These are in separate client name accounts belonging to policyholders.

Diversification

Segregated funds allow individuals to invest into professionally managed sub-accounts that best suit their investment needs.

Guaranteed Death Benefit

Should the policyholder die, the beneficiary is guaranteed the amount originally invested, minus proportionate withdrawals. Some age limits may apply.
Liquidity
Most segregated funds allow policyholders to withdraw up to 10% of the segregated funds value (up to 20% for retirement income plans) without penalty.

Avoids Probate
Upon death proceeds are paid directly to named beneficiaries avoiding probate and other estate settlement costs.

Penalties for early withdrawal
When purchased on a deferred sales charge basis there is a redemption fee that may apply.

Market Value Fluctuation
The value of a segregated fund is subject to market value fluctuations.

A CONTRACT OF LIFE INSURANCE
A policy is the evidence of a contract that exists between the insured (policy owner) and the insurer (Life Insurance Company). The contract sets out the terms under which a sum of money will be paid to the policyholder at a future date.

Contract Provisions Provide:
• Protection of the policy owners’ rights.
• Compliance with Provincial Laws.

Standard Provisions Include:
• Basic guarantees
• Commitment to pay stated Benefits.

Insurable Interest exists:
• In your own life
• Life of their child, grandchild, spouse, employee
Pecuniary Interest:
- When permission to insure (signature) is given.

**General Provisions Memory Key: SCALP, RIB & TOE**

S - Suicide
C - Conversion Privilege
A - Age Adjustment
L - Loans
P - Premium Payments

R - Reinstatement
I - Incontestability
B - Beneficiary Designations and Changes

T - Tables of Non-Forfeiture Values
O - Optional Modes of Settlement
E - Entire Contract

**GENERAL PROVISIONS OF AN INSURANCE POLICY**

**Suicide Clause**
Most Contracts will pay the full amount after two full years of payments. If suicide occurs after issue and before two years, most companies will refund the premiums.

**Conversion of Term Coverage**
Most Term Contracts allow for the conversion of up to the face amount to Permanent Insurance (Cash Value Insurance). The new premium us usually the attained age standard rate. Some contracts allow for the exchange of policies, with cash values, provided the face amount remains the same. As long as there is no increase in the risk to the insurer, no medical requirements would be likely to be requested.
Age Adjustment
When an insured’s age is incorrectly stated it is treated as an error. Adjustment is making by adjusting the benefit by what would have been purchased by the premium paid if the correct age had been given.

Loans
Policyholder can use their C.S.V., as collateral to borrow money from the Insurance Company. Interest will be charged for the loan until it has been repaid. Loans impair both the Cash Surrender Value if subsequently withdrawn and the face amount at death is not repaid.

APL (Automatic Premium Loan)
As an added loan feature, each contract allows for the automatic payment of premiums, by way of a loan, if the premium remains unpaid after the 30 days of grace. Interest is charged on the accumulating loan.

Premium Payments
Actuaries calculate premiums as if paid, annually in advance. Any more frequent payment method will increase the cost to the policyholder. If death occurs, the unpaid premium will be deducted from the death benefit. The 30 days grace period would apply and any overdue premiums would be recovered from the death benefit if death occurred to the insured. Method of payment usually can be changed on request.

Reinstatement
Policies may be reinstated up to two years (sometimes longer) after lapse, provided that:
- The policyholder pays the back premium, plus interest and any other indebtedness.
- Provides evidence of Insurability.
Incontestability
The Insurance Company has the right to question any material facts for the first two years of the contract, after which the policy shall be incontestable except for misstatement of age or fraud.

Beneficiaries
Each applicant has the right to name the individual who is to receive the face amount in the event of his or her death. The proceeds of a policy can pass to a named beneficiary outside the deceased’s Will. The naming of beneficiaries and the use of the settlement option in fact creates a Trust or an “Insurance Will”.

WHAT HAPPENS TO THE INSURANCE MONEY WHEN IT IS PAID?
Insurance Money carries a special connotation. It refers to the actual sum assured payable to a Named Beneficiary rather than other sums held to the credit of the insured (Proceeds on Deposit Pre-paid premium account, etc.).

Disposition of these items should be noted separately in a Will. If the Insurance Money is to be passed by, Will, naming the Insurance, as an Estate asset to be passed and declaring this a Beneficiary Declaration will remove doubt.

If the Insurance is passed as an asset without naming a Beneficiary, the proceeds are not creditor proof. It would be advisable to name the Life Insurance Company and Policy number in passing the proceeds, as this would provide possible creditor protection.

Insurance proceeds can be paid out to one of five general categories:

1. The estate of the Insured.
2. Specifically named person(s).
3. A class of classes of persons.
4. A business organization.
5. A trustee.
1. **Estate**

The Estate is not included as a beneficiary designation, but can be named never the less. It should only be named to provide liquidity. A transfer of death proceeds directly to a named beneficiary may be less complicated and certainly reduce taxation to the estate.

In the event of minor children, the proceeds can be directed to their guardian “In Trust” for their care and maintenance.

2. **By passing the money directly to a named beneficiary the client has the following benefits:**

   - Undue administration costs.
   - Possibility of creditor claims.
   - Settlement options may be utilized.
   - Payments made quickly and directly.
   - Bypass the estate eliminating the possibility of probate.

3. **Class**

If by name, the insured creates a risk that child born/adopted after the date of the Will, will be excluded as well as children who predecease their parent. Class designations are created when an insured names all children born or adopted “to the marriage of my spouse and myself”.

This directs the proceeds to all children alive at the time of the insured’s death, as well as protecting the share of any deceased child by passing that share equally to their children. This therefore conveys the “Right of Survivorship.”

4. **Business Organizations**

A large volume of Insurance today is sold to protect the Business Interests of the owner. The beneficiary designation needs to be worded with care, to carry out the intent and for the purpose for which the insurance was issued.
5. Trust
A trustee may be named by the policyholder to transfer the Insurance proceeds to a Trust or other organization, which has been instructed as to the management and/or investment of the moneys. The Insurance Company should be consulted as to the wording of the beneficiary declaration.

NAMED BENEFICIARIES
The Uniform Insurance Act in each Province, other than Newfoundland regulates the Naming of Beneficiaries.

Beneficiaries may be named in:
The Application
- The Application – This is pretty straight forward. You can name the beneficiary directly in the application and also state the relationship between the insured, applicant and beneficiary.

Separate Declaration (Separate Document or Named in a Will).
The Declaration need not be registered with the Insurance Company to be valid and the designation, except an irrevocable designation, may be made by Will or Codicil. Even if a Testamentary Document does not fulfill all the requirements for a valid Will, it may well serve as a Beneficiary Declaration.

Since the Declaration with the most recent date constitutes the effective declaration, it is worth noting that the date the Will was written is the effective date, rather than the date of death.

Some General Beneficiary Information
Designations and The Law (common-law Provinces) Beneficiary’s designations were changed and replaced by current designations effective July 1, 1962.
Prior to July 1, 1962 Status
Beneficiary for value always refers to a debt owed and a guarantee of payment. A preferred beneficiary creates a Trust and always referred to a family group namely: Husband, Spouse, Children, Father, Mother and Adopting Parents. An owner wishing to change beneficiaries, needed to obtain the permission of the “Preferred” Beneficiary, but was allowed to change it to someone else in the Preferred Class. Naming a Preferred Class restricted all use of the policy regarding collateral use or assignment.

Preferred and beneficiary for value conveyed creditor proof status. When the beneficiary designations were changed after July 1, 1962, both beneficiary for value and preferred beneficiary retained their protection.

Post July 1, 1962 Status
Two designations replaced the previous three.

Naming a beneficiary “Irrevocable” placed the control of changes in the policy in the hands of the beneficiary. No changes, except minor, may be made without their consent. Any beneficiary named therefore will automatically be revocable unless specifically designated as irrevocable.

When Policy proceeds are payable at death, the funds become the property of the beneficiary and therefore cannot be seized by a creditor.
Changes in Naming a Beneficiary
The owner has the right to change the Beneficiary at a will (except an Irrevocable) and to name a contingent beneficiary as well as a contingent owner.

Changing a beneficiary can be accomplished by document where a change form is completed and signed and forwarded with the policy for registration and policy amendment. More common now is that the form is filled out in duplicate, and after being registered by the Head Office, one copy is sent back to the policyholder.

Divorce does not change the beneficiary for policy is issued before 1962 or after, and if change is required, a declaration must be forwarded. As in Preferred Status, an Irrevocable Beneficiary must give permission to the change.

Minors
A minor may own Insurance at age 16 but may not be named a beneficiary until they reach the age of 18. Funds may be paid to a Guardian to be held in Trust or paid into the courts if one has not been named.

Simultaneous Death
If the Insured & named beneficiary are killed in the same, accident the beneficiary is deemed to have died first and a “common disaster” clause may extend this provision for a certain length of time e.g. 30 days. If a contingent beneficiary had been named, the proceeds would pass to them. It should be noted that if the proceeds are paid into the Insured Estate, the Will may dictate their dispersal or if intestate, the Law may provide for their passing.

Spendthrift Provision
An Insured can direct that the beneficiary, through the settlement options, may receive only an income payment and this will not be subject to the beneficiary’s creditors’ claims for food, clothing, and shelter - the necessities of life from being paid.
ADDITIONAL NOTES TO THE LIFE INSURANCE CONTRACT

Reinstatement
When a policy is reinstated, the suicide and incontestability period (2 Years) must be fulfilled again.

Incontestability
If the question of materiality arises concerning the information contained in the application, the Law asks:

- Was the representation untrue when made?
- Was it of such a nature as to influence the action of the Company in accepting the risk?
- Did the Company rely on the facts as presented to accept the risk and issue the policy?

Assignment
The assignee assumes all the rights to the policy, except the right to name the beneficiary.

Waiver of Premium
Generally, total disability must occur before age 60, after a waiting period of 3 to 6 months.

War Clause
Some older contracts contain a War Clause that prohibits the payment of the death benefit if the insured’s death occurs because of war activities.

Supplemental Provisions of an Insurance Contract

Accidental Death, Disability Clause, Waiver of Premium; Waiver of premium plus Monthly Income, Payor Waiver and Guaranteed Insurability Benefits.
WHEN DOES AN INSURANCE POLICY TAKE EFFECT

Application is an offer to the Insurance Company. The Insurance Company either accepts the offer or makes a counter offer. Either the Company or the applicant must make an offer that is acceptable to the other party exactly as offered.

There are two types of applications

1. **Trial Offer**
   This is an application without premium. A trial offer is a submission to the Company as a basis for a future offer. If the Company accepts this evidence, or requires a medical, and if when completed all evidence is favorable, will issue a contract as their offer. Upon payment of initial premium, the policy is in effect.

2. **Application with Money**
   If the statement of health, or subsequent medical information, personal history, lifestyle and occupation is acceptable, the Company will issue a contract.

The Policy takes effect:

- By Law, when policy is delivered to the Insured, the policy is in effect.
- By Practice, when policy is delivered to Agent, the policy is in effect, provided no change in insurability has occurred.

Conditional Insurance Agreement

Upon completion of an application and prior to policy issue, when a premium has been paid, a Conditional Insurance Agreement is given that provides for the payment of the Insurance in the event of death, provided the Insurance Company would have issued the Policy as applied for.
AN OVERVIEW OF CANADIAN INSURERS

Below is some information as provided by research conducted by the Canadian Department of Finance in November of 2004:

• Canada’s life and health insurance industry comprises some 105 firms, down from 168 companies operating in the sector in 1990. Canadian life and health insurers include companies incorporated both domestically and abroad.

• With the increased consolidation in the industry, the five largest companies represent over 54 per cent of the domestic market in terms of premiums, and 57 per cent of domestic general assets, up from 48 per cent in 1994.

• In the Canadian market, the market share of Canadian-controlled companies has increased over the past decade from 69 per cent to 72 per cent of total premium income collected.

• International operations have become increasingly important to Canadian insurers. Foreign premium income now accounts for half of the sector’s total premium income.

• Retirement products such as annuities, registered retirement savings plans and registered retirement income funds represent one of the fastest-growing areas of the life and health insurance business.

• Regulation of Canada’s life and health insurance industry is shared between the federal and provincial governments.

• With respect to prudent regulation, the federal government, through the Office of the Superintendent of Financial Institutions, supervises the federally incorporated firms (including foreign firms), which account for over 90 per cent of the total sector’s premium income.
• While there is some market conduct regulation at the federal level, all insurers are subject to market conduct regulation by the province in which they carry on business.

• Legislation was passed in 1999 allowing the life and health insurance companies to convert from mutual companies (owned by policyholders) to stock companies (owned by shareholders). Canada’s five largest life and health insurance companies are now publicly held.

**Canadian Insurers consist of the following types of structure:**

**Stock Companies - Owned by Shareholders**
An insurance company formed as a corporation that is owned and controlled by stockholders, usually for profit. Initial capital is contributed by stockholders, to whom profits are distributed as dividends. Policies are issued at a fixed cost, and should losses exceed premiums received, the stockholders’ investment and equity must make up the difference.

**Mutual Companies - Owned by participating Policy holders**
An insurance company that has no capital stock, but is owned by its policyholders, who elect a board of directors or trustees through whom business is conducted. Any earnings belong to the policyholders and may be distributed to them as policy dividends or reduced premiums.

**Fraternal Association - Owned by the members**
A “fraternal benefit society” means a body corporate:

a That is without share capital,

b That has a representative form of government, and

c That was incorporated for fraternal, benevolent or religious purposes, including the provision of insurance benefits solely to its members or the spouses, common-law partners or children of its members.
Selecting an Insurance Company

How Do I Decide Which Company To Use?

Once the amount of insurance needed, and the type of policy desired is determined, the next decision is the selection of a company.

*Important considerations are:*

- **Cost** - Costs may vary greatly from company to company, but cheapest is not always the best.
- **Comparative Policy Benefits** - The policy provisions, guarantees, historical performance are but a few of the factors which may vary from company to company and should be considered.
- **Financial Strength of the Issuing Company** - The insurance company’s financial strength and stability as well as its national and local reputation are extremely important. Certain rating services are available to assist in comparing the financial aspects of companies being considered.

**Insurance Company Ratings**

- A.M. Best Co. rates the financial strength of insurance companies and the security of holding company's debt and preferred stock.
- Standard and Poor's also provides independent ratings and analysis in a wide variety of financial areas.
- Moody's is another well-recognized provider of credit ratings, research and financial information.

**Availability of Local Professional Financial Advisor**

The client or prospect will find the most able assistance with their insurance purchase through a local professional agent/adviser. This individual can help them to analyze their personal situation and determine the amount, coverage type and provisions that will best meet their needs. Remember, there is no one policy that is right for all situations.
Clients and prospects today want to deal with someone who has kept up to date with their financial education. This may include dealing with someone who holds the following financial services designations - CLU/Chartered Life Underwriter, ChFC /Chartered Financial Consultant; or CFP/Certified Financial Planner.

As the demographics are changing, and your clients and prospects are aging, they are turning more and more to advisors who have attained their Elder Planning Counselor (EPC) Designation which is the premier “elder” designation in Canada today. For more information the website is – www.cieps.com.

WHAT OTHER CONSIDERATIONS ARE THERE IN DECIDING ON A LIFE INSURANCE PURCHASE?

Finally, there are some unique features of life insurance, which make it a very valuable financial planning tool in some situations:

- Death proceeds are received income tax-free (as long as the policy has met statutory requirements).
- The growth of cash value within the life insurance contract grows on a tax-deferred basis. So, no taxes are currently due. This is true so long as the policy remains in force.
- If the cash value is ultimately withdrawn or the policy is surrendered prior to the death of the insured, the withdrawal is income tax free up to the total basis (premiums paid) of the policy. Thereafter, the gain is taxed as ordinary income.
- Policy loans are a non-taxable event, unless the policy is later surrendered with the loan still outstanding.
- Dividends paid on Whole Life policies are non-taxable, since they are considered a return of premium. (However, any interest paid on dividends left on deposit in the policy is taxable.)
- Death proceeds payable to a named beneficiary do not become part of the estate, and generally are not subject to estate debts.
CANADIAN INSURANCE COMPANY MERGERS & ACQUISITIONS

If your clients or prospects have a policy and know the Canadian insurance company but can't find it, the following list of insurance company mergers and changes of ownership may help you.

- Abbey Life was bought by ITT Hartford Life Insurance Company of Canada, which was later bought by AIG Life Insurance Company of Canada.
- Aetna Life bought Financial Life and Excelsior Life and then Maritime Life bought Aetna Life.
- Aeterna Life was taken over by Desjardins Group.
- Canada Life was bought by Great West Life in 2003.
- Crown Life was bought by Canada Life.
- CNA Life was bought by Canada Life.
- Colonia Life changed its name to Concordia Life and then Empire Life purchased Concordia Life and is currently in the process of integrating all its products and systems.
- Confederation Life's individual life insurance contracts and segregated funds were bought by Maritime Life.
- Commercial Union Life was bought by Manulife Financial.
- Counsel Life was bought by Security Life which was then bought by Co-operators Life.
- The Credit Life changed to Union Fidelity Life.
- Financial Life was bought by Aetna Life and then Maritime Life bought Aetna Life.
- Gerling Global Life and Sun Alliance were bought by Royal Life which changed its name to Royal & SunAlliance Life. This company has now been purchased by Maritime Life.
- Glacier National Life was bought by The Bank of Nova Scotia.
• Holland Life Insurance Society Ltd. was purchased by Commercial Union Life in 1973. In April 2001, Commercial Union's individual life book of business was assumed by Manulife.
• Imperial Life was taken over by Desjardins Financial Security.
• Laurentian Life was absorbed by The Imperial Life Insurance Company of Canada.
• Laurier Life became a division of Imperial Life which was then taken over by Desjardins Financial Security.
• Liberty Health was bought by Maritime Life in 2003.
• London Life was bought by Great West Life but still operates as London Life and markets under the name of Freedom 55 Financial.
• Maritime Life was bought by Manulife Financial in 2004.
• Mony Life was bought by NN Life which then became Transamerica Life.
• Monarch Life was bought by North American Life which is turn was bought by Manufacturers Life.
• Metropolitan Life of Canada was bought by Mutual Life which has since changed its name to Clarica. Metropolitan Life accumulated some brokerage life insurance sales which Mutual Life didn't want so those clients were sold to Equitable Life. Some older, paid up industrial policies are still retained by the original Metropolitan Life and can be tracked down by using the toll free number 1-877-210-2212.
• Mutual Life changed its name to Clarica.
• Mutual of Omaha was purchased by RBC Life.
• North American Life was bought by Manulife Financial.
• New York Life was absorbed by Canada Life.
• NN Life was bought by Transamerica Life.
• Norwich Union was bought by AIG Life Insurance Company of Canada.
• Paul Revere Life became Provident Life & Accident Insurance Company which later became Unum Provident Canada.
• Prudential Life Insurance Company of England was bought by Mutual Life which has since changed its name to Clarica.
• Royal & SunAlliance was purchased by Maritime Life.
• Seaboard Life was bought by North West Life which in turn was bought by Industrial Life. Industrial Life then changed its name to Industrial Alliance Pacific Life Insurance Company.
• Sovereign Life's individual life insurance book of business was assumed by Standard Life after the Ontario Superintendent of Financial Services took over control of the company in 1992.
• Unum Provident Canada was bought by RBC Life in 2004.
• Westbury Life and Canadian General Life joined and the combined company was renamed Westbury Canadian Life. Westbury Canadian Life was then bought out by the Royal Bank who continued the operation for a while as Westbury Life and then changed the name to RBC Life.
• The Federal Civil Service Mutual Benefit Society was taken over by Sun Life.
• Toronto Mutual Life changed its name to Unity Life.
• Transamerica Life was bought by Aegon but continued under the Transamerica Life name.
• U.N.A. Life was absorbed by Maritime Life.
• Western Life changed its name to Unity Life.

The above list was provided by Mr. John Beaton, Financial Advisor, Beaton Financial Services, White Rock, BC

SOME INSURANCE STATISTIC FROM CANADIAN LIFE & HEALTH INSURANCE ASSOCIATION (CLHIA)

• There were 105 life and health insurance companies operating in Canada at the end of 2004.
• Almost 24 million Canadians and their dependants are protected by one or more of the life and health industry's products and services.
• At the end of 2004, Canada’s life and health insurers held $341.9 billion in assets on behalf of Canadian life and health insurance policyholders. Most of the total was invested in Canada’s economy, primarily in government bonds ($72 billion), corporate bonds ($64.2 billion), corporate stocks ($50.1 billion), mutual funds ($62.1 billion), commercial mortgage loans ($23.9 billion), and residential mortgage loans ($17.7 billion).

• In 2004, Canadian life and health insurers generated $62.5 billion or 54% of their total worldwide premiums (and premium equivalents) from foreign clients for life insurance, health insurance and annuities. Some 20 million people in more than 20 countries outside Canada own life insurance policies with Canadian companies.

• 116,100 people were working in the life and health insurance business in Canada: 51,800 full-time employees and agents, and 64,300 independent agents earning at least part of their income from the life and health insurance industry.

• In 2004, Canadians paid a total of $58.2 billion in premiums (and premium equivalents) on existing and new policies.

• By year-end 2004, Canadians owned $2,610 billion in life insurance.

• During 2004, Canadians received $48.1 billion in payments from life and health insurance companies, including payments under uninsured contracts.

• During 2004, Canadians purchased about 856,100 individual life insurance policies

WHAT ARE SOME OF THE FUTURE CHALLENGES IN THE INSURANCE INDUSTRY?

Like other players within the financial services industry, the life and health insurance sector is undergoing rapid change. Technology is having an impact on all aspects of the sector, from distribution – policies can be bought at any time from any place over the Internet – to online trading of company shares.
Growth in information technologies is also globalizing financial markets and has led to a significant increase in cross-border financial transactions. Consumers have greater access to insurance products, whether they are domestic or foreign, and can access those policies which best meet their needs. Competition is also increasing from other financial institutions including banks and mutual fund dealers, who offer a wide range of investment products.

The sector also faces challenges from the changing demographics of the North American population. The strong popularity of annuities is partly due to the desire by the baby boom generation for retirement income. As this segment of the population ages, it could affect the distribution share of life and health insurance products, with annuities making up a larger portion of the market. The proportion of annuities being paid out will also likely increase. In addition, the aging of the population will likely affect claims paid out for the more traditional life insurance products.

In the face of these pressures, the life and health insurance sector continues to consolidate. Industry analysts expect this trend to continue, as demutualization provides the share capital needed for acquisitions. Some smaller life and health insurance firms may meet these challenges by focusing on niche markets.

The legislation to reform the regulatory framework governing the financial services industry is intended to support the life and health insurance sector in meeting these challenges by providing a flexible environment in which to operate, while maintaining strong prudential regulations. The new framework maintains the long-standing practice of ensuring regular updating of the regulatory framework by including an automatic five-year review in the legislation. The Government is also prepared to revisit the legislation prior to the five-year review, if necessary, to ensure the framework keeps pace with the rapidly changing marketplace.
**CONCLUSION**

For many of today’s insurance companies, dealing with a certain amount of complexity has become a very competitive and time consuming challenge. The globalization, low investment returns, reserve deficiencies, pressure to enhance shareholder value, and the many industry consolidation are the main factors driving business decisions in the insurance industry today.

Deregulation has intensified pricing competition. Competition comes not only from other insurance companies, but also from banks, and alternative risk management mechanisms. As well, financial reforms around the globe are creating new regulatory and governance environments, affecting the economics of doing business.

To survive and thrive in this environment, insurance companies must stay focused on their mandates and the bottom line. Growth areas such as increasing premiums, adding additional debt and/or capital, leveraging technology and other processes successfully to reduce costs, to the point of realigning their lines of business will contribute to the insurance companies expansion within niche or specialty markets.