Life Insurance

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Concept

Risk management

```
Risk avoidance
Risk reduction
Risk retention
Risk transfer
```

Insurable interest

```
insurable interest (only need exist when the policy is issued)
- own life
- spouse life
- child/grandchild
- key employee
- anyone would financially impact the policyholder
```

Risk of death

```
variables would impact one's "risk of death" in a given year
- age and gender
    - premium goes up with age; male is more expensive than female
- personal and family health history
- smoking status
- employment and income level

two ways to quantify the "risk of death"
- life expectancy
- probability of death
```

```
risk of disability = morbidity

FPO rider is for disability insurance, not life
```

Insurance purpose

```
Insurance purpose:
- loss of income
- loss of a caregiver; eg. a spouse didn't earn income
- debt repayment
- income taxes; eg. deem disposed of an asset
- estate creation; for parents with little money to leave for kids
- education funds
- legacies; eg. a financial gift to students of a university
- charitable giving
- business continuation
```

Charitable donation

```
charitable donation
- when alive, up to 75% of the current year's income
- when diseased, 100% of the current and prior year
- non-refundable tax credit is higher for the portion > $200
    - so one should claim the entire donation for a family
```

Choose insurance type

Temporary vs permanent etc

```
- temporary insurance needs
    - eg. mortgage, education
- permanent needs
- join first-to-die
    - eg. pay off mortgage
- join last-to-die
    - eg. leave benefit to disabled kid
- decreasing
    - eg. mortgage
- increasing
    - eg. tax on capital gain on a cottage which increasing in value
- small WL for kids as life insured with GIB
    - to lock the insurability
    - assign the policy (transfer ownership) to the kid when adult
    - GIB allow him to add additional amounts on certain dates and within
certain limits with evidence of insurability
        - small amount → due to insurable interes
```

Annuity

```
annuity
- to address "risk of living too long"
```

Creditor proof

```
- a beneficiary other than the policyholder/estate is named
- the relationship of the beneficiary to the insured
    - part of the protected family class (spouse, child, grandchild)
    - irrevocable beneficiary
```

Riders

Waiver of premium for total disability benefit

```
- the premium, the riders and the supplementary benefits be waived
- after the applicable waiting period
- the supplementary benefit is appropriate if the policyholder also the life insured
    - if others paying the premium, different rider "parent/payer waiver benefit"
```

Renewable or convertible

```
- no policy gain → no tax consequence
- term policy; no cash value, no dividends, no policy loans
```

Non-forfeiture options (WL)

```
- CSV (cash surrender value)
- APL (automatic premium loan)
- reduced paid-up insurance
- extended term insurance
```

AD&D

```
- can provide double indemnity
- the death is caused by an accident

- exclusion for AD&D (but basic death benefit will pay)
    - self-inflicted injury (drug overdose or suicide)
    - criminal act (drunk driving)
    - act of war, murder
    - piloting non-commercial plane (fly a plane for pleasure)
```

GIB (guaranteed insurability benefit)

```
- allow add coverage without evidence of insurability and regardless of health
- if added after policy issued, evidence of insurability required
- the amount of additions, the maximum age can be exercised is decided by insurer
```

PUA (paid up additions)

```
- can only be added to a permanent insurance, eg. WL and UL (not sure if UL has it)
- for WL, only apply to participating policy
- dividend option (not non-forfeiture)

- policy dividends is not guaranteed
    - it is good to show multiple dividend illustrations when discussing dividend options
```

```
- waiver of premium dividend option
    - reduce premium only when and if a policy dividends is paid
    - is standard on disability policy, but an added feature for life
```

Others

```
- LTC (long term care)
- Child coverage rider
- Term rider
```

Premium = cost of insurance

```
more expensive UL > WL > T-100
```

Universal life (UL)

```
- calculate NAAR (net amount at risk)
    - face value = death benefit (when level death benefit option)
    - LCOI/YRT mortality costing option
    - premiums paid
    - accumulated investment component

    - NAAR = death benefit - investment amount
```

```
- funding
    - minimally funded
            premium only cover insurance cost and expenses, no more for investment
            → cash value = 0

    - maximum funded
            cash value is as high without failing the exemption test

- to increase investment (opposite to decrease)
    - larger deposit
    - better investment return
    - smaller mortality deduction
    - lower policy expense
```

```
- mortality charge (deduction)
    - a fee to compensates the insurer for any losses due to unexpected events
      eg. a death benefit paid sooner than expected
```

```
    - the average fee about 1.25% per year

- mortality charge based on YRT (yearly renewable term)
    - the mortality charge (cost of insurance) per $1,000 of NAAR is lower in
the early years
    - more left to invest, the accumulating fund can grow faster
    - for more sophisticated client (higher risk)
    - the mortality charge will increase as time goes on
    - the hope is the growth in investment can reduce NAAR so to keep the cost
manageable
    - greater short-term policy value

- mortality charge based on LCOI (level cost of insurance)
    - more mortality cost in earlier year, but never increase
    - less to invest in the beginning
    - for more conservative investor
    - looking for longer-term policy value; less chance of lapsing
```

Whole life (WL)

```
- participating (offer potential dividends) more expensive than non-
participating

- limited payment WL
    - the entire premium being paid over a fewer years, so annual premium is
higher
    - the total premium cost is lower
        as the insurer applies the time of value of money principle
    - the premium can be paid off at known time; eliminates longevity risk
```

```
- APL (automatic premium loan) is included in a WL policy
    - missed premiums were loaned with interest
    - cash value is used as collateral
    - death benefit is reduced by the loan plus interests
```

```
- only face value is paid out at death (no adding cash value)
```

Term

```
- Modal factor (also for WL)
    - annual premium * modal factor = monthly/quarterly/annual payment
```

Full need analysis

```
- calculate money needed
    - keep percentage of salary / rate of return (net return = after tax)
      (capitalization of income method)
    or
    - calculated by (monthly expense - monthly income) x 12 x years
    (capital drawdown method)

      - mortgage paid off
    - funeral expenses
```

```
    - car loan
    - capital gains tax owned on dispose of property

- calculate money available
    - life insurance benefit (group/personal)
    - sell house/car/business
    - liquidate investment

- calculate money shortfall
```

```
- replace net income in perpetuity
    - net return = gross return x (1 - weighted average tax rate)
    - insurance required = net annual income / net return

- if to replace gross income
    - insurance = gross income / gross return
```

Tax

General

```
- premium is not tax deductible in most of cases
    - the exception is used to secure a loan for business or investment purpose

- death benefit is paid out tax free to the beneficiary
    - CPP death benefit is taxable
```

```
- dispose property
    - tax owing = (capital gain x 50%) x MTR
      - capital gain = current value - ACB
```

```
tax upon death
- RRSP deemed to be withdrawn and full taxed
    - unless spouse rollover
- CPP/QPP (maximum = $2,500)
```

UL

```
- UL (universal life) = buy term + invest the difference yourself

- fail exemption test → non-exempt (after 60 day grace period)
    - deemed disposition (policy gain = CSV - ACB → full taxable)
- 3 ways to remedy (fix) the failure
    - increase face amount (coverage)
    - withdraw money from the accumulating account/cash value
    - move to side account (=shuttle account); taxable
- MTAR (maximum tax actuarial reserve) room
    - measure the cash value is reasonable to the coverage and length of policy
time
    - when there's room, side account can be transferred back

- surrender a policy
```

```
    - ACB (adjusted cost basis) = Premium paid - NCPI (Net cost of insurance) - Dividends paid
    - policy gain = CSV (cash surrender value) - ACB
    - tax owing = policy gain x MTR
      - full gain is subject to tax; treated like bank interests
    - proceeds net of tax = CSV - tax owing

- reducing coverage → deemed disposition/partial surrender of a policy (after 1982/12/1)
    - prorate = 1- (new face value / original face value)
    - prorated policy gain = (CSV - ACB) x prorate
    - tax liability = prorated policy gain x MTR
```

```
- anti-dump-in rule = the 250% rule
    - prevent a policyholder from making large lump-sum deposits
        - after the 7th anniversary on a policy that's minimum funded
    - beginning on the 10th year and every after
        - the accumulating fund comparing to 3 years ago
    - if the increase is > 250%, the rule will apply
        - ETP (except test policy) is reset to 3 years ago
        - result in a lower MTAR on the test policy, so harder to pass the exemption test
```

```
- dividends paid out
```

WL/UL

```
- policy loan
    - considered a partial disposition of the policy
        - results in a policy gain
    - when repay the loan, can deduct the repayment upto above gain amount
    - if the repay exceed the gain amount, the remainder will add to ACB
        - higher ACB will reduce the tax when surrender

    - when used as a collateral for a loan, the premium can be tax deductable
        - only the premium associated with the loan amount
        - only the NCPI (net cost of pure insurance) can be deducted
            - no investment portion = term insurance
```

Dispose of CCPC

```
- dispose of CCPC (Canadian-controlled private corporation)
    - $800,000 lifetime capital gains exemption (LCGE) per individual
    - capital gain = sale proceeds - ACB - unused LCGE
    - only 50% is taxable
    - tax owing = taxable capital gain x MTR
```

Calculate benefit

WL

```
- benefit =
    + (face value + interest)
    + (term addition + interest)
    - (outstanding loan + interest)
    - (terminal illness benefit + interest)
        as it is previously paid
```

Business insurance

Different structures

```
advantage/disadvantages on different structures:
    - cross-purchase agreement vs. share redemption plan
    - criss-cross insurance vs. business-owned insurance

business owned life advantage:
    - business pay premium instead of each partner
    - premiums are not tax deductible and paid with after-tax dollars; corporate has lower tax rate in general
    - compared to criss-cross insurance approach, far simpler than each partner to buy insurance on every other partners
```

Buy-sell agreement

```
buy-sell agreement
    - the company owns the policy and pays the premiums
    - when one owner dies, his shares are transferred to his estate
    - the insurer pays the death benefit (tax free) to the company's CDA (capital dividend account)
    - other owners pay the deceased owner's estate for his shares with a promissory note
    - other owners instruct the company to pay them tax-free capital dividend
    - other owners use dividend to pay off the promissory note
```

Group insurance

```
- probationary period = waiting period
- enrolment period = eligibility period
- actively-at-work requirement
```

Convert to individual

```
- convert to individual
    - amount for Quebec: $400,000
    - others: $200,000
    - without providing proof of insurability
    - need to convert within 31 days of termination of group coverage
```

What can be controlled by employee

```
- beneficiary designation

not controllable:
- premium split
- co-insurance factor
- single deductible amount
- membership class
```

Underwriting

Rated

```
- rated
    - excessive alcohol user
    - risky avocations (hobbies)
    - frequent travel
    - major driving convictions

- smoker/non-smoker (not rated, just higher premium for smoker)
```

Waiver of premiums

```
- risk of death
    - underwrite on the life insured
- waiver of premium
    - underwrite on a policyholder (pay the premium)
    - if he is disabled, the premium is waived
```

MIB/APS

```
- MIB (medical information bureau) report
    - medical info
    - hazardous hobbies
    - adverse driving records
- APS (attending physician's statement)
```

Mistakes on policy

```
- void a policy (no fraudulent error, eg. misstatement of age)
    - life-insured age older than max
    - still alive
    - error noticed in 3 years
    - void in 60 days of notice

- deny a claim
    - during the contestability period (first two years)
    - material misrepresentation even in the absent of fraud
    - can't deny when misstatement of ago or gender unless fraud
      - coverage (benefit) is adjusted by the percentage of paid / correct
premium
```

Delivery of policy

```
- in person
- sign acknowledgement that no change in insurability
- when change in insurability, no delivery
- collect the first premium
- 10 days free look provision (= right of rescission), start right after
delivery
```

Policy illustration

```
- policy illustration
    - help to understand the policy
      - for term
        - only show the premium payable and death benefit each year
    - for permanent
        - more complex; eg. including investment component, cash value etc
```

TIA

```
- valid until the earliest of
    - the main policy is approved and delivered
    - the applicant being advised in writing that policy is declined
    - maturity date in TIA, eg. 60, 90 days

- only given when an agent reasonably sure the underwriter will issue the policy
    - travel plans to certain destinations could make the application being
rejected
```

Claim

```
- process
    - notice of death
    - complete claim form, including
        - insured's age
        - claimant's name, age, identity
        - proof of death
```

Authority

```
- CLHIA (the Canadian life and health insurance association) guideline

- to protect clients from churning or twisting
    - Quebec: Notice of replacement of insurance of persons contract
    - others: Life insurance replacement declaration (LIRD)
    - it provides
        - a warning not to cancel existing until new is in place
        - a list of questions so that the client should know or find the answer
```

Others

Creditor life insurance

```
- provide by bank
- if cancelled within 20 days, the premiums is refunded

- CLHIA guide
    - the borrower must be advised the creditor insurance is optional
    - the borrower has 20 days to change his mind with full refund
    - can cancel at any time
    - all terms and exclusion be fully disclosed
    - disclose the amount of premium and how it's determinded
    - once apply, coverage is subject to approval by the insurer
    - the insurer might inform the client if declined
```