

The Need for Modernization of Ontario's Legislation Regarding Life Insurance Policies

Cashing-In or Drawing a Loan on Seniors' Life Insurance Policies A Vitally Important Alternative For Ontario's Seniors

Low Investment Returns, Longer Life Expectancy, Increasing Costs

The goal of this article is to:

1. Advise readers of the importance of modernizing Ontario's life insurance legislation;
2. Recommend changes that would enable Ontario's seniors to optimize the value of their life insurance assets for retirement living;
3. Freeing the insurance advisors to act in their clients' best interests.

These changes should be made as soon as possible given the many years of low investment returns, coupled with an aging population with longer life expectancy and increasing medical costs.

Uncertainty surrounds the Corona virus pandemic and equity market volatility. The declining interest rates have led to concern from many seniors as to how they will sustain enough regular income to maintain their lifestyle.

Life Insurance; An Asset

When money is tight there are two key areas that can be addressed. The first is an increase in income and the second is the cutting of expenses. For many seniors, support can be provided in both of these areas if they are able to utilize the true value of their life insurance policies. Now more than ever, the ability for seniors to access the fair market value (FMV) of this asset is vitally important. These same seniors foresee the looming debt crisis of the extensive government programs being introduced and prefer to solve their problems using their own insurance assets as compared to foisting the cost of this crisis on their children and grandchildren.

Section 115 of Ontario's Insurance Act

Since the 1930s, Section 115 of Ontario's Insurance Act has prohibited *"any person other than an insurer or its duly authorized agent from trafficking or trading in life insurance policies."*

This has created a "monopsony". That is whereby a single buyer – in this case the Canadian insurance company from which the policy owner has purchased the policy – is the only party allowed to purchase or lend against the value of an owner's policy.

Naturally, this influences the selling price because since there is one buyer, the price offered to the policy owner is less than its fair market value. Like insurance companies, some financial institutions are

permitted currently to lend against a policy using the cash value of the policy as collateral. However, since cash value is non-existent in term policies and generally a small component of permanent policies, this alternative does not provide much access to the policy owners' fair market value.

Bill 219 Modernization of Ontario's Legislation

By modernizing legislation now, during the Covid-19 crisis, insurance policy owners could maximize their policy value by selling or borrowing from third parties (life settlement/loan providers), in addition to their insurer.

Bill 219 received Second Reading in the Legislature on October 29, 2020. It goes to The Standing Committee on Economic and Financial Affairs in January 2021. Bill 219 amends the prohibition so that it does not apply if the life insurance policy is sold or assigned by the original policyholder or a transferee, used as collateral security or donated to a charity.

The Bill provides for a 10-day cooling off period, during which time an agreement to sell, assign, use as collateral security or donate a life insurance policy may be cancelled. The Financial Services Regulatory Authority of Ontario is required to provide oversight in respect of the transaction.

Other Jurisdictions

In other jurisdictions such as Quebec, New Brunswick and Saskatchewan, or internationally in the U.S., the U.K., Japan and Germany where third parties are allowed to buy insurance policies or make loans based on the insurance policy as collateral, the market has typically provided a fair market value of four to eight times higher than the value offered to policy owners by their insurer.

Life insurance owners should have the fundamental right to optimize "their asset" as they see fit given their life insurance policy is their personal asset.

Insurance policies issued in Canada provide contractual rights to the owner (subject to the rights of an irrevocable beneficiary or lender) to change beneficiary status, policy ownership and/or assign his or her policy as collateral.

And yet, Section 115, sneakily removes these rights by only allowing insurance policy holders to sell their policies to their insurance company.

In the United States, one key aspect of life insurance ownership is that such policies have been established in law as personal assets as early as 1911 in a landmark U.S. Supreme Court case (*Grigsby v. Russell*). An August 1, 2013 article in *Advisor's Edge* submitted by Sunlife Financial entitled "*Life Insurance As An Asset Class*" by Wayne Miller, BMATH, ASA, ACIA and Sally Murdock, MMATH, MMF, CFA implicitly supports the case for treating an insurance policy as a personal asset in a Canadian context.

Canadian Life Insurance Policies

When policy owners first acquire their policies, it is typically based on a specific priority. Priorities, however, often change over a lifetime. Unless there is a specific need, some seniors prefer income or capital for their retirement years rather than a death benefit that will benefit their heirs.

Currently, policy owners in this situation have only two options if they no longer require the death benefit or if their premiums become unaffordable.

- Option 1:** **Let their policy lapse** – in which case the owner receives the current cash surrender value (CSV) from the insurer but does not have to pay future premiums and their beneficiaries do not receive the death benefit.
- Option 2:** **Borrow a percentage of the CSV, cash surrender value**, from the insurer, pay interest on the policy loan and keep the premiums current; thereby retaining the death benefit less the policy loan at death.

These limited options have contributed to a significant portion (estimated as high as **80%**) of life insurance policies **never paying out their death benefit**.

Third Party Life Settlement and Loan Providers

By introducing third party life settlement and loan providers, life insurance policy owners would be able to sell a life insurance policy or obtain a loan from a third party which expands policy owners' options to include:

- Option 1:** **Sell all, or a portion of their policy to a third party** (called a life settlement provider) at a FMV which is typically a multiple of what insurers will pay for the policy's CSV, if any exists. Premiums are assumed by the purchaser, and the death benefit to the original owner's beneficiaries is reduced by the percentage of the policy sold.
- Option 2:** **Borrow from a third party called a life loan provider** based on the FMV (fair market value) collateralized solely by the policy (similar to a reverse mortgage), also typically providing significantly more than its CSV (cash surrender value), if any exists. Premiums are assumed by the lender, interest on the original advance and premium payments is accrued and is repaid out of the death benefit – with the residual paid to the owner's heirs.
- Option 3:** **Borrow to pay the premiums** of their policy in exchange for proportional ownership in the death benefit of their policy. The death benefit to the heirs of the original owner is reduced by the percentage of the policy encumbered by the loan.

Result: Influx of Cash for Seniors

An open market for life insurance policies will not only provide an influx of cash for the policy owner, but will also reduce their cash outflow, likely allowing many more owners to maintain at least a portion of the death benefit for their heirs – rather than lapsing their policy.

Bill 162 and Bill 20

During the past few years, Bill 162 and Bill 20 have been introduced to the Ontario Legislature. Bill 162 would have enabled third parties to buy and sell life insurance policies. Bill 20 would have enabled third parties to provide loans based on life insurance policies as collateral. These bills died when the Ontario election was called in 2018. Both of these bills would have established a secondary market for all life insurance policy owners. (This article focuses on seniors since they will be the most likely life insurance policy owners to contemplate selling their policies or obtaining loans based on their policies, although others with life-shortening disabilities are also applicable.)

These bills were opposed by the Canadian Life and Health Insurance Association (CLHIA). Its views, which were published on October 17, 2017, can be summarized as follows:

1. **A limited market in Canada:**

Reasons cited were that term policies would not be eligible and few permanent policies lapse – a statement that is not accurate since licensed life settlement providers actively acquire and lend against both permanent and convertible term policies. Furthermore, a U.S. study of seniors found, not surprisingly, that 90% would have considered a life settlement or loan versus lapsing their policy had they been informed in advance.

2. **Current availability of advanced death benefits:**

Despite the Canadian Life and Health Insurance Association assertions, only when the insured is terminally ill is there any actual track record of policy owners receiving a voluntary advanced benefit. For example, several people in their 90s met by life settlement providers were denied advanced death benefits in 2017, 2018, and 2019.

3. **Potential for fraud or abuse:**

Despite the Canadian Life and Health Insurance Association assertion, there are no known incidents of fraud or even formal complaints in the Canadian provinces where third parties are allowed to buy life insurance policies.

Furthermore, the U.S.-based National Association of Insurance Commissioners reported in October 2018 that fewer than 0.1% of life insurance complaints were due to life settlements. 99.9% of formal complaints were against insurers themselves, or their agents.

Real Reason Insurance Companies Are Opposed

The Life Insurance Settlement Association of Canada (LISAC) believes that the real reason the Canadian Life and Health Insurance Association is opposed is that the insurance companies may face lower policy

lapse ratios and will no longer be able to cancel policies for the price of their cash surrender values (CSVs). Naturally, this lowers their profitability. However, this profitability is currently being realized at the expense of their policy owners.

The Life Insurance Settlement Association of Canada and Canadian Life Settlements (a leading licensed life settlement provider in Ontario) have offered to meet with senior executives of insurance companies, Canadian Life and Health Insurance Association representatives, the Financial Services Commission of Ontario now known as the Financial Services Regulatory Authority. Both the Life Insurance Settlement Association of Canada and Canadian Life Settlements have invited them to participate in articles, webinars and debates on this topic. Each of these groups has consistently declined to engage in productive discussions. Keeping this important, largely seniors issue, out of the public appears to be the preferred way for those hoping to maintain the status quo to deal with this matter of critical importance.

Seniors Best Interests

Clients of licensed life insurance and financial planning advisors expect their advisors to inform them of opportunities that are in their best interests. And yet, life insurance companies have consistently warned licensed advisors – even in provinces where life settlements and loans are currently available – not to participate in or advise their clients to participate in life settlements or life loans. In fact, several advisors have had their insurance contracts withdrawn by all of the major insurers. That is not acting in the best interest of clients.

In conclusion, the time has come to respect the rights of consumers, in this case, mostly seniors. It's time to modernize Ontario's Insurance Act and eliminate the gross imbalance created by Section 115.

Consumers can be protected by legislation that requires rights of rescission (cancellation), the opportunity for policy owners to consult with their financial advisor and/or lawyer and the regulators of life settlements by the newly-formed Financial Services Regulatory Authority of Ontario; which began operations in June 2019.

Senior citizen-consumers and industry participants are urged to make their opinion known by contacting their MPP. In these uncertain times, it is more important than ever that people are allowed every opportunity to utilize their own assets to ensure their financial well-being.

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