LIVING BENEFITS

NEW FRONTIERS

Advisors need to remain abreast of changes in the insurance landscape.

By David Wm. Brown

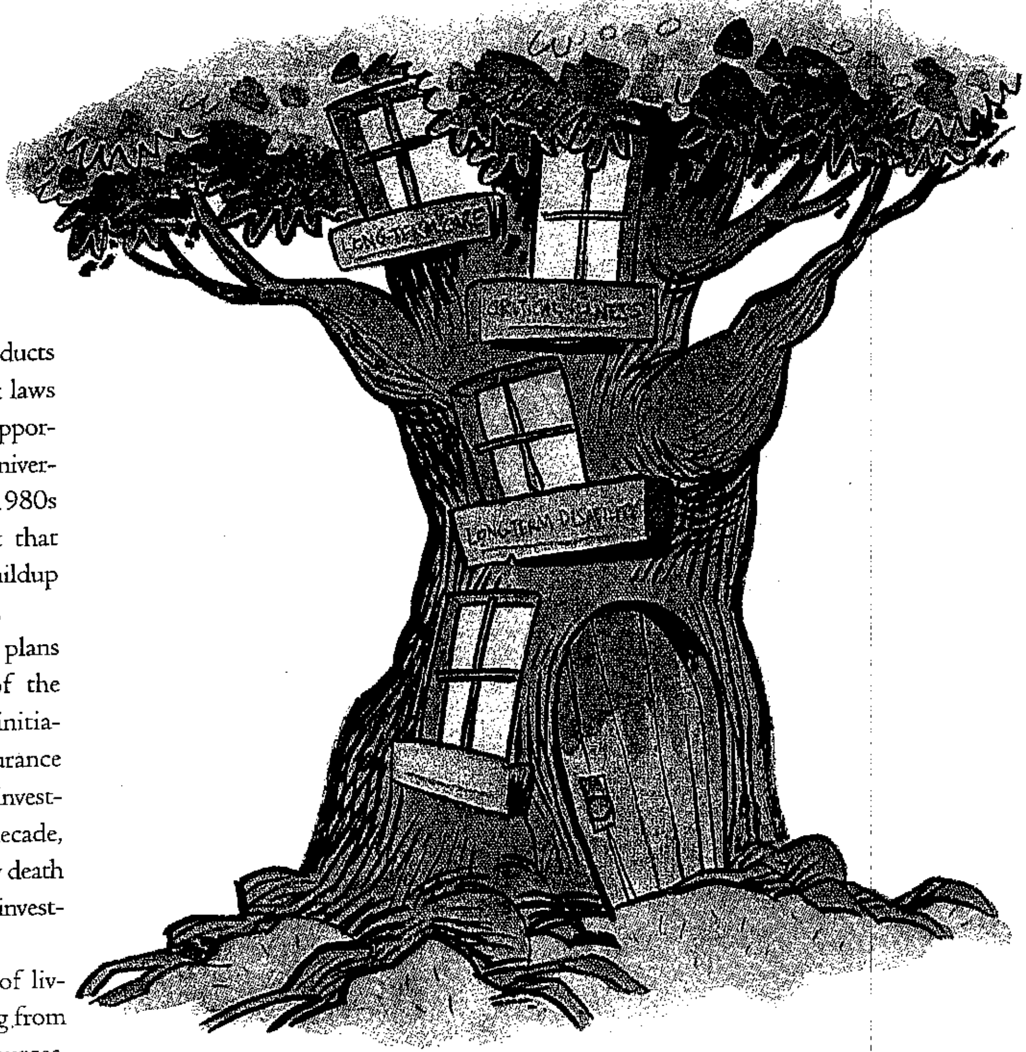

Illustration by Dave Whamond

Development of new insurance products is usually driven by changes to tax laws or the creation of new investment opportunities. That was the case when universal life was developed in the early 1980s in response to a federal budget that addressed tax advantages of the buildup of cash in life insurance contracts.

Term-to-age-100 life insurance plans and the new money products of the 1980s also came in response to initiatives dealing with changes in insurance laws, taxation rules and a shifting investment environment. During that decade, life insurance evolved from a purely death benefit product to a financial and investment planning instrument.

But the relatively young genre of living benefits products didn't spring from any of those traditional sources. Instead, they were created in response to shifting demographic trends and changes to the Canadian healthcare system. Seniors represent Canada's fastest-growing population segment—expected to reach 6.7 million in 2021—and advances in healthcare are lengthening average life spans.

As baby boomers enter their 50s and 60s, they've begun worrying about how they'll maintain their consumer-oriented lifestyles, which require significant disposable wealth. Living benefits products respond to those concerns by providing funds to let an insured person maintain the standard of living he or she became accustomed to during the wealth-accumulation years.

Living benefits—in the form of products like income replacement insurance or disability income (DI) coverage—have been available for some time. Designed to provide income in the event a sickness or accident renders the insured unable to perform his or her occupation, DI coverage is still an important component of a well-rounded insurance portfolio. Business overhead expense plans, disability loan protector plans and disability buy-out plans are less well-known options. In 1995, a new disability contract called the tax protector was created to deal with new tax rules. The product is now being phased out in response to the sunsetting of that rule.

Continued on page 5

Continued from page 3

Group and individual health and dental benefit plans are also a form of living benefits. Designed to supplement provincial healthcare plans, these contracts are in a constant state of flux as government offerings erode and responsibility for healthcare is slowly shifted from the public to the private sector. As the balance tips, private plans will continue to become more robust, and increasingly expensive to maintain.

Our neighbours to the south have one type of living benefit plan that's still in its infancy in Canada but which will likely grow exponentially over the next few years. Long-term care (LTC) plans provide a daily or monthly income for people who require treatment in a facility or at home. The contracts differ from DI in that benefits aren't triggered by an inability to work but rather the inability to do at least two daily living activities. They also can be triggered if a person is cognitively impaired and requires either residency in a care facility or professional assistance at home.

Depending on the policy, benefits can be payable to the insured for a specific period, or even a lifetime. In Canada, only a few thousand of these contracts have been sold and only a handful of insurance companies have bothered to design and market them. However, it's likely they'll become more popular as the population ages.

It was against just such a backdrop that Dr. Marius Barnard developed the concept of critical illness (CI) insurance. He responded to advances in medical technology by creating products that catapulted the term living benefits to the forefront of insurance planning. But despite the hype, few advisors are actually discussing living benefits plans with clients.

According to LIMRA International's *Canadian Individual Critical Illness Insurance Sales* report, the number of new CI policies sold increased by only 3% during 2004. And many of those sales came as the result of experienced advisors trying to beat anticipated increases in the price of CI policies. When those price increases kick in, they'll likely slow future growth of CI contracts and may create an environment in which products are priced beyond the reach of many clients.

But CI plans are still in a state of evolution. Each month the list of covered illnesses seems to grow as companies vie for position by adding non-critical illness or early intervention benefits. Limited payouts for procedures such as coronary angioplasty are being introduced and graded benefits based on the severity of diagnosis are becoming more popular. Some companies are linking their products to things like concierge medical services or assistance plans that help people manage day-to-day activities, or to mental health support programs to help people deal with the fears that accompany a serious ailment.

To attract clients, new products are being offered on a guaranteed issue basis with pre-existing limitation clauses. Grouped individual and group CI plans are slowly becoming a component of employers' group health plans. Many of the plans are offered on a guaranteed issue basis with amounts of up to $100,000 per employee, with some offering optional coverage for spouses and dependents. (See "Employer opportunity" on page 14.)

And more change is in store. Discussions are getting underway to create standardized definitions of illnesses covered by CI policies. If adopted, there

Continued on page 7

INSURANCE DEFINED

Living benefits are among the many types of insurance products advisors must understand.

- WHOLE LIFE INSURANCE: combines the low-cost protection of term insurance with a savings component that is invested in a tax-deferred account, the cash value of which may be available for a loan to the policyholder.
- UNIVERSAL LIFE: allows a policyholder to shift money between the insurance and savings components of the policy, creating more flexibility than whole life.
- LONG-TERM DISABILITY INSURANCE: pays benefits in the event a policyholder becomes incapable of working.
- CRITICAL ILLNESS INSURANCE: pays out a lump sum to the insured in the event of a serious illness, namely a heart attack, stroke or cancer.
- LONG-TERM CARE INSURANCE: provides benefits for the chronically ill or disabled over a long period of time.
- COMBINATION INSURANCE PRODUCTS: a relatively new type of insurance policy that mixes long-term disability, critical illness and long-term care insurance.

Source: www.investorwords.com

Continued from page 5

would be only one definition for illnesses such as a heart attack, stroke or cancer. That would lead to companies having to compete on the basis of price, number of illnesses covered, service and underwriting. The current environment, in which standardized definitions don't exist, increases the complexity of products immeasurably. Proponents of standardization argue the current definitional hodgepodge discourages advisors from talking to clients about purchasing CI plans.

It's likely the pricing of CI plans will continue to be tweaked as the product range matures and the companies accumulate more experience selling them and paying claims. Premiums for the guaranteed products may still rise notwithstanding the fact they've already been increased significantly. Other companies may choose to limit the illnesses covered or promote non-guaranteed premiums. Eventually, the price of return of premium options may increase so much that purchasers opt for increased coverage and forfeit the premium return option.

Sophisticated advisors and companies will soon look at combination products such as the LifeBeat plan launched by AXA. Marketed exclusively by the managing general agent Megacorp, this product is likely the first of its kind in Canada. It is a combination of CI and LTC. The concept may be slightly ahead of its time and will require some fine tuning, but remains compelling. It's designed to only require the client be insurable at the entry point, but then provides benefits that change alongside his or her needs.

It begins as a CI plan but then morphs into a LTC plan. In other words, it's designed as a complete living benefits package. There's one challenge: The contract is both expensive and complicated. Advisors already have a hard time explaining the specifics of CI recovery plans and LTC plans to their clients. So combining the two products multiplies the challenge. The insurance industry has not done a good job of providing education for advisors who want to sell CI or LTC to clients. They'll need to correct that if they want advisors to be comfortable selling these kinds of combination products.

Other new products offer combinations of both personal DI and CI coverage with flexible return of premium benefits. Universal life contracts are also available that combine CI benefits with LTC riders for the insured or for

Continued on page 9

Continued from page 7

family members. In these plans the cash accumulates and is used for the CI or LTC premiums.

In the future, we'll likely see more combination products as companies try to develop offerings that follow an insured throughout his or her lifetime, and house all living benefit risks under one contract. The products will protect a client in the event of an accident, sickness or a serious illness. They may also provide health and dental benefits. And they'll be able to be converted into a LTC plan and eventually may pay out a benefit on death.

There are, however, at least two significant roadblocks to these types of products. The first is the advisor's ability to explain all the terms and permutations to the client—sometimes too much flexibility is a problem. The second will be the CRA's facility to rule on the taxability of these types of products. Currently the CRA is unable to give a specific ruling on the taxability of CI products, especially those with additional options such as return of premium on death and maturity. A combination type product would further complicate the issue.

Nevertheless, the combination products will ultimately help clients. It still will take some clarification and education by providers before they're embraced by many insurance advisors. In the meantime, it's incumbent on advisors to learn and understand the details of the currently available plans so they can provide the best advice and service to clients. IE

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