

# UNDERWRITING PERSPECTIVE

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## Investor Owned Life Insurance – Not good for our industry

There has been a great deal of focus on the impact of investor owned life insurance policies in the United States (U.S.). Although illegal in all provinces except Nova Scotia, New Brunswick, Quebec and Saskatchewan, these types of sales are starting to appear in the Canadian market. In Quebec where it is legal, one must issue a prospectus when bundling 3 or more policies. These sales impact both the ceding companies as well as the reinsurance market overall.

In simple context, investor owned life insurance are insurance policies which are generated by third party investors who lack insurable interest in the insured but whose sole purpose is to profit from the proceeds of the death benefit as an "investment vehicle". They profit in the following way: 1) The insured receives cash to have his/her life insured 2) the investor gets paid the death benefit which is far greater than the amount invested 3) the lending institution gets interest on the loan.

Generally, these policies are set up in the following way:

- the policy is owned by a trust which is set up on behalf of the investor/s who pays the premiums
- the funds used to pay the premiums are borrowed from a finance company and the policy itself is collateral for the loan
- applicants are older age individuals whose life expectancy is reduced

If the purpose of issuing these policies is solely to be used as a vehicle for investment purposes with no insurable interest, this negates the intended use, and accepted practice of a life insurance policy for the purpose of income replacement, estate preservation, etcetera against premature death. Since legitimately the Canada Revenue Agency (CRA) allows for tax free benefits on loans and build up of cash values it encourages a wide variety of sales concepts however the investor owned life insurance is not tolerated as it can negatively impact insurers profitability. Examples that could negatively impact insurance carrier's profitability include but are not limited to:

- Underwriting older ages with complex medical histories leaving room for marginal error when determining the correct ratings. Most of these individuals are older and may or may not be an impaired risk. Remember that the shorter the individual's life span the better the ROI is for the investors.
- Aggressive underwriting in a competitive broker market which is further amplified by table shaving programs.
- Marginal lapse rates for level COI products which in turn affect the entire block and overall pricing.
- Financial underwriting that overstate the need for insurance coverage creating over-insurance.
- Inaccurate life expectancy tables being used to evaluate the Fair Market Value of a policy.
- Ongoing market competitive pricing.
- Inaccurate use of life expectancy tables, trust creation, premium financing.
- Sustainability of the insured for loan payments.
- Multi-life charitable situations where the entity underlying the group is the beneficiary. They are usually older, same issue dates and are bundled and sold in the secondary market.
- Reduction of an individual's insurance capacity.

Another important consideration is the future tax treatment of investor owned life insurance. Currently these policies are not taxable in Canada but it is conceivable that if these policies are considered under securities regulation, they would be subject to taxation. Historically in the U.S. this has been the area of most abuse of clients of any insurance market. Many U.S. and Canadian insurers are now instituting clauses in their advisors contracts stating any third party ownership or sale of investor owned life insurance will result in advisor cancellation.

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Similarly, insurers should have procedures in place to monitor owner and beneficiary changes to glean any patterns of abuse. In the U.S. claims have been denied where insurers have proved that the client was planning to change ownership later (after 2 years) when they purchased, thereby misrepresenting the insurable interest. Insurable interest is taken into account at time of issue and since a company cannot prevent future owner beneficiary changes as they are contractual, insurance carriers have no recourse. We have one shot at determining insurable interest and that is at time of Underwriting and cannot dispute at claim time insurable interest related to the death benefit.

As a whole our industry must be diligent and make every effort to not accept or promote investor owned life insurance. It is not healthy for the insurer or the client. If this concept becomes widespread in Canada we may face in the future regulatory consequences that could impact the current favourable tax treatment that life insurance policies enjoy.

*This article is intended to provide general information only and should not be considered as BMO Life Assurance Company's final underwriting position on the condition(s) addressed here.*