LLQP Pre-Study

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What is insurance? Insurance is a financial arrangement (contract) between two parties, in which one of the parties (the insurer) agrees to protect the other party (the insured) against a specified financial loss, in exchange for a specified payment (premium). If the loss occurs, the insurer will pay the insured an amount of money (benefit) to compensate for the loss. As you can see, insurance is an agreement between the insurer and the insured; but what would motivate these two parties to come to such an agreement? To put it quite simply: protection and money.

1. **Life Insurance, in General**

As a consumer you wish to insure (or protect) certain things which you hold valuable. In life insurance we protect against the financial impact the loss of our lives (death) may have. However how can we be sure that we are properly protected? What factors go into determining our coverage? Who is involved in the process? This first section is an introduction into the world of insurance.

**Parties to an individual insurance contract**

There are four parties to an individual insurance contract:

**Insurer**

The insurer pays the benefit when the covered risk occurs.

**Policyholder-insured**

The policyholder is the owner of the insurance contract. He or she is a party to the contract along with the insurer.

**Life Insured**

The life insured is the person on whose life the life insurance contract is taken.

**Beneficiary**

The policyholder designates a beneficiary, who receives the benefit when the covered risk occurs. The policyholder is not required to designate a beneficiary.
Basics of insurance

There are five guiding principles which life insurance is based on. These basics are the foundation on which insurance principles are made.

The five guiding basics of insurance are:

i. Meeting commitments to the insured

The insurer makes a written commitment to pay out a certain amount following the occurrence of a specific risk.

ii. Creation of a reserve

The creation of a reserve allows the insurer to meet claims-related requirements of policyholders after the life insured’s death.

iii. The law of large numbers

The more the number of analyzed results or events there are, the more it is possible to determine the probability of these results or events based on the anticipated probabilities.

iv. Equitable sharing

According to this principle, each person must contribute a premium that reflects the risk he represents to the group.

v. Mutual benefit

This principle implies that, by forming groups, it is easier to pay claims, since all the members of a group will not have an insured risk happen in the same year.

Mortality rate

The mortality rate is used in life insurance to determine the premiums required to cover the risk of death. It is the ratio of deaths to a given population. For example, the mortality rate is the number of expected deaths per year per thousand in Canada for people alive in the beginning of the year, at each age from 1 to 99 years old, for men and women separately.
2. **Term Life Insurance**

There are two main categories of life insurance: Term and Permanent. Term insurance, also referred to as temporary insurance, is the simplest form of life insurance. As the name suggests, it is insurance that is for a term or a specific period of time. The following is a brief summary in order to identify the main concepts involved in term insurance.

**Primary characteristics**

**Limited duration**

Usually term life insurance is valid for a specific number of years.

_example:

Michael, age 30, takes out a 20-year term life insurance policy. As such, he is covered for the next 20 years (to age 50).

**Renewal rights**

This means that the policy may be renewed after the initial term without evidence of insurability (proof of health).

_example:

Mary, 28, takes out a 10-year term life insurance policy with a face amount of $100,000 that is renewable until age 65. The premium will be renewable and will increase in 10 years for another 10-year period. This pattern will continue until the policy anniversary following Marie’s 65th birthday.

**Conversion privileges**

Policyholders may choose to convert (change) some or all of the term life insurance into permanent life insurance with no evidence of insurability.

_example:

Philip, 46 years old, took out a 10-year term life insurance policy 8 years ago. The policy has a face amount of $100,000 and is renewable and convertible until age 65. Today he can choose to convert the policy (or some of the term) into permanent insurance with no evidence of insurability, by paying the premium applicable to his age group, without exceeding the face amount of $100,000 in permanent coverage.
Types of term life insurance

Decreasing term life insurance or mortgage insurance

The face amount (also known as the death benefit or capital insured) decreases on an annual basis, but the premium is level (remains the same) for the contract period.

The right to convert term insurance to permanent insurance applies to the remaining face amount at the conversion date.

Example:
Frank, 31 years old, took out a decreasing term life insurance of $15,000 with his financial institution to purchase furniture, with 60-month amortization. If Frank dies while his loan balance is $7,000, this balance will be paid in full, not the initial amount of the loan.

Term life insurance with a uniform or fixed face amount

Insurance amount and premiums are fixed for the contract period. The premium increases upon each renewal (at the end of the contract period).

Example:
Alicia, 28 years old, recently completed her notary studies and has started business in partnership with one of her former classmates. Alicia decides to take out a 10-year term life insurance with a $25,000 face amount that is renewable and non-convertible. This contract will be renewable every 10 years, with the premium rising upon each renewal, but with the same face amount.

Term life insurance clientele

As term is time specific insurance it is best suited for those who need coverage for a specific period of time. As well term insurance is the most affordable insurance available.

Typical term life insurance clients are:

- Young couples
- Business partners
- People with specific needs for a specific time period
- Individuals with limited finances (budget)
- Individuals who want to protect their debts from their creditors
3. **Permanent Life Insurance**

Permanent insurance may be categorized in several types of insurance. These include whole life, term-to-100 and universal life insurance. As the name implies, this category of insurance is permanent, or until death.

**The Different Types of Permanent Insurance**

**Whole life insurance**

Premiums are due for the life insured’s entire life. The premiums are level and guaranteed for life.

**Limited payment whole life insurance:**

- Premiums are payable only for a specified time period.
- Level and guaranteed premium.
- The fewer the payments, the higher the annual premium and the cash surrender value is higher as well.

**Example**

*Paul, 46, bought a 10-pay $100,000 whole life insurance policy on his own life. He only has to pay premiums for 10 years on this policy. From 56 years of age, premiums will no longer be due and the coverage will remain in place until the insured dies (or age 100).*

**Primary characteristics of whole life:**

Three guaranteed elements:

i. Death benefit
ii. Fixed premium
iii. Cash value**

**Cash value (or Cash Surrender Value):**

- Portion of premiums used as savings which accumulate within the policy and are payable when the policyholder terminates his contract
- Cash value is different from death benefit
- The amount is known in advance with a whole life insurance
- A portion of the cash surrender value (policy gain) is taxable when withdrawn in a lump sum
- May or may not be payable upon death
Non-forfeiture options

Many consumers worry about what would happen to their life insurance if they were unable to pay it. Since whole life insurance contains a savings amount (cash surrender value) this allows for the option of not having to pay premiums, while still keeping some form of insurance in place. These are known as non-forfeiture provisions and have four applications:

Reducing the value of the policy

Reducing the coverage amount of the original contract and eliminating premiums until the insured’s death. Also known as reduced paid-up insurance, the coverage has been reduced from the original amount to a lower amount (reduced), however premiums are no longer due (paid-up).

Extended term insurance

In this case, the whole life insurance contract is converted into a term insurance policy in the same amount as the original face amount, but for a lesser period, until the cash surrender value is nil over time. Depending on the amount of the cash surrender value, the length of time the term insurance will be valid will vary.

Automatic premium loans

The insurance will be automatically kept in effect using the cash surrender value as payment for the premiums. Each month the premium payable to the insurer is removed from the cash surrender value. These advances are loans made from the policy and must be reimbursed with interest.

Policy loans

The insurer can grant the insured a loan up to 90% of the cash surrender value of his whole life policy. The policy holder is not bound by a strict repayment schedule however he is charged interest at current rates. The difference between automatic premium loans and policy loans is that the policy loan is deposited into the client’s bank account to be used at his discretion.
Example of non-forfeiture options

Insured, David, 22, with a permanent life insurance
Face amount: $25,000

<table>
<thead>
<tr>
<th>Policy year</th>
<th>Guaranteed cash surrender value</th>
<th>Reduced paid-up insurance</th>
<th>Extended term insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>At age 60</td>
<td>$11,850</td>
<td>$20,625</td>
<td>17 years and 200 days</td>
</tr>
<tr>
<td>At age 100</td>
<td>$25,000</td>
<td>$25,000</td>
<td>N/A</td>
</tr>
</tbody>
</table>

At age 60, David has six options:

i. He can keep on paying the premium and remain insured in the amount of $25,000.
ii. He can withdraw the cash surrender value of $11,850, thereby cancelling his contract.
iii. He can stop paying the premium and obtain $20,625 in permanent life insurance for the rest of his life with no premiums due (reduced paid-up insurance).
iv. He can stop paying the premium and obtain a $25,000 term insurance for a period of 17 years and 200 days (extended insurance term).
v. He can pay the premiums via automatic advance and remain insured as long as the cash surrender value is positive (automatic premium advance)
vi. He can apply for a policy advance as long as the amount does not exceed the cash surrender value (policy or contract advance).

Term-100 (T-100) life insurance

Term-100 (T-100) insurance provides level and guaranteed coverage until the age of 100. Because T-100 insurance does not normally contain any cash value, the premiums are lower than a whole life policy (for the same amount of coverage).

Example

John, 40, took out a $150,000 term-100 life insurance policy offering coverage until age 100. John will pay a fixed premium for the entire length of the contract.

Universal life (UL) insurance

Universal life (UL) insurance combines two components in a single contract: a life insurance portion and an investment portion. Since UL includes investments rather than savings, as is the case for whole life, the investment portion is not guaranteed. Investments fluctuate in value and the returns earned depend on the performance. The following are characteristics of universal life insurance:
Flexible premium

You are not required to pay an annual fixed amount. The premiums can vary between a minimum (cost of insurance, fees, and taxes) and a maximum (calculated based on certain criteria for tax purposes) which includes an investment component.

Advances or withdrawals

Policy advances or withdrawals may be made. These are not considered loans, unlike whole life.

Tax sheltering accumulation

As long as certain rules are respected and as long as the money remains in the policy, the investment portions and the returns earned on the investment are not subject to tax. At death all amounts received by the beneficiary are considered a death benefit. Death benefits received from life insurance are never taxable.

Premium calculations

As stated, premiums in UL policies are flexible. The reason for the flexibility is found in the way the premiums for a UL policy are calculated. A UL policy holder can choose one of 2 methods for calculating the actual cost of the life insurance portion.

Yearly renewable term (YRT)

These calculations are based on the insured’s age and increase each year of the policy. As the policy advances in time and the insured’s age increases, the cost of the life insurance portion increases. As a consequence, in the beginning while costs are low, a greater portion of the premium is directed to the investments. This investment portion, participating in market growth, can be used later on to offset the rising costs of insurance.

Level of insurance (LCOI)

These costs are based on the insured’s age as at the contract issue date and remain the same for the duration of the contract. If a policyholder put equal amounts into both YRT and LCOI contracts, less will go into the investment component of an LCOI because the cost of LCOI is higher in the early years when compared with a YRT contract.
Death benefits

- Level death benefit

  The death benefit remains constant; it does not change over time.

Example

Ann took out a $100,000 fixed face amount universal life insurance policy. At her death, her estate will receive $100,000.

- Indexed death benefit

  The death benefit is adjusted by the cost of living. It increases annually according to the rate of inflation.

Example

In 2008, Bernard took out a $100,000 indexed universal life insurance policy with an annual indexing rate of 2%. He died in 2011. His estate will receive $106,121 (the death benefit is indexed at 2% for 3 years).

- Level death benefit plus account value

  The death benefit increases over time to include the investment portion. Both the amount which was taken as life insurance and the investment portion plus any growth (returns) on these investments will be paid to the beneficiary as one amount, tax free.

Example

Sue took out a $100,000 universal life insurance policy with an increasing face amount. At her death, the investment portion totals $12,000. Her estate will receive $112,000.

Clients

Whole Life and T-100

- A method of forced savings (whole life);
- Coverage with a guaranteed premium;
- Guaranteed coverage during the insured’s lifetime;
- Levelled premium;
- Permanent needs
**Universal Life**

- Provides required coverage and investments all in one
- For clients with good debt control and surplus funds to invest
- For clients who annually maximize their registered retirement savings plan (RRSP) and tax-free-savings account (TFSA) contributions
- For investment savvy investors looking for tax advantaged investment opportunities

**Comparing main types of life insurance policies**

<table>
<thead>
<tr>
<th>Life insurance</th>
<th>Duration</th>
<th>Premiums cost</th>
<th>Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term</td>
<td>Specific period</td>
<td>Cheap (coverage only)</td>
<td>Individuals with coverage needs for a specific period of time and who have a limited budget</td>
</tr>
<tr>
<td>Universal</td>
<td>Until age 100</td>
<td>Variable (based on invested savings portion in addition to the coverage)</td>
<td>Individuals with good investment knowledge seeking tax-sheltered investments &amp; who need permanent insurance coverage (good debt control and maximized RRSP &amp; TFSA contributions).</td>
</tr>
<tr>
<td>Whole Life and T-100</td>
<td>Lifetime</td>
<td>Higher (coverage + savings)</td>
<td>Individuals seeking a way to force savings, need long-term and guaranteed coverage, and a guaranteed &amp; level premium</td>
</tr>
</tbody>
</table>
4. **Common Clauses, Terminology, Riders and Supplementary Benefits**

The first three chapters of this guide provided you with a basic understanding of life insurance. Chapter Four will expand your knowledge by explaining some of the common clauses and terminology found in life insurance contracts. In addition, chapter four will also discuss some of the ways that policyholders can customize their policies with riders and supplementary benefits. Although they do not change the basic function of the insurance policy, riders and supplementary benefits allow for additional insurance coverage on family members or enhanced benefits. The insurance company adjusts the premiums to reflect the riders and benefits added to the policy.

**Common insurance clauses and terminology**

**Grace period**

This is the time limit that the insurance company grants to the policyholder to pay his premium. There is no grace period for the first premium payment. For subsequent premiums, the grace period is 30 days.

If the policyholder were to die during the grace period, the beneficiary would be entitled to the face amount, less the overdue premium.

**Lapsed contract and reinstatement**

A lapsed contract is simply a contract that is no longer in effect. A policyholder can reinstate a lapsed contract by satisfying the following conditions:

1) **Make a request**

The reinstatement request must be made within two years of the lapse date.

2) **Provide evidence of insurability**

The insured must provide evidence that he represents the same insured risk as in the original contract.

3) **Pay overdue premiums**

The policyholder must pay the overdue premiums and the interest accrued.
4) **Repay premium loans**

The policyholder must repay any premium loans (plus interest) he received from the insurer before the contract lapsed.

**Incontestability clause**

An insurer cannot contest a policy after it has been in force for two years unless there is evidence of fraudulent misrepresentation. It is considered a fraudulent misrepresentation when the applicant knowingly withholds material information from the insurer at the time of application and the information withheld could impact the decision to approve the application. If fraudulent misrepresentation is proven (for example an insured who failed to disclose a history of cancer), the contract can be cancelled.

**Suicide clause**

If the suicide occurs less than two years after the effective date of the life insurance, the face amount will not be paid and the premiums paid from the beginning of the contract will be refunded to the beneficiary.

If the suicide occurs more than two years after the effective date of the policy, the face amount will be paid.

The two year period applies to increases in the face amount as well.

**Example**

*If suicide occurs eight months after a $50,000 increase to the original contract of $100,000, a contract that has been in effect for four years, the insurer will pay a death benefit of $100,000 to beneficiaries, not $150,000.*

**Beneficiary Designation**

The beneficiary is the person designated to receive benefits under a life insurance contract upon the death of the life insured. There may be more than one beneficiary in a life insurance contract.

An insurable interest must also exist between the policy owner and the life insured. An example of an insurable interest is the relationship between a parent and his child or the relationship between two business partners.

**Example**

*An ordinary citizen cannot insure his country’s Prime Minister for $1 million that he would receive at the Prime Minister’s death.*
**Revocable and irrevocable beneficiary of a life insurance contract**

A revocable beneficiary may be revoked (changed) without beneficiary’s consent while an irrevocable beneficiary assignment cannot be changed without the written consent of the beneficiary.

Only the policyholder may designate a beneficiary in individual insurance and annuity contracts. The beneficiary must exist at the time of the insured person’s death, but not necessarily at the time of the designation.

**Example**

*A child who has been conceived but is not yet born may be designated as the beneficiary if it is born alive and viable. That child would be recognized as the beneficiary following the death of the insured person.*

**Payment of Death Benefits**

Insurance benefits are always received tax free by the beneficiaries. However, beneficiaries must be the age of majority in order to receive the death benefit. If the beneficiary is a minor, the death benefit is paid to his parents or his legal guardian or trustee. If a person is over the age of majority but incapable of caring for himself, the death benefit is paid to the individual’s guardian or trustee.

**Policy Assignment**

Assignment means that the owner of a life insurance policy transfers ownership to another person with an interest in the insured’s life or health.

**Example**

*A parent purchases life insurance on the life of his son and transfers the ownership of the contract at the child’s age of majority.*

**Riders and supplementary benefits**

A policyholder can broaden the death benefit on a base policy with riders and supplementary benefits. Riders bring increased flexibility to the policyholder by allowing him to customize a basic policy to meet his needs. The following riders are discussed in detail in the LLQP program:

- Paid-up additions (PUAs) rider
- Term insurance rider
- Accidental death (AD) rider
- Guaranteed insurability benefit (GIB) rider
Supplementary benefits are benefits that are made available to the insured during his lifetime. Depending on the type of the benefit, they may or may not affect the amount of death benefit paid out on the death of the life insured. The following supplementary benefits are discussed in detail in the LLQP program:

- Accelerated death benefits
- Accidental dismemberment benefit
- Waiver of premium for total disability benefit
- Parent / payor waiver benefit

Depending upon the rider or supplementary benefit chosen by the policyholder, additional underwriting and premiums may be required.

**The Application Form**

The application for insurance is completed by the Life Insurance Agent and the client. The Life Insurance Agent must collect the client’s information and record it accurately on the application form. The insurance company, through a process called underwriting, evaluates the risk that the client represents. The risk assessment results in the assignment of a premium for the policy.

**Temporary insurance agreement (TIA)**

The process for applying for insurance can take several weeks. If a client has no insurance in place and has an identified need for life insurance, a temporary insurance agreement can be put into place by the Life Insurance Agent. To qualify for the temporary insurance, the applicant must answer a short health questionnaire and pay the first month’s premium on his life insurance application.

**Contract Period**

A contract may be renewed or ended.

*Contract renewal*

The renewal is evidenced by a certificate of renewal or the issuing of a new policy after the expiry of the initial contract.

*End of contract*

There is a difference between the termination and the cancellation of the contract.
**Termination of contract**

The termination of a contract means that the contract does not exist anymore, as if it had never existed.

The main reasons of termination are false representations, fraud, concealment (not telling all the truth) and insurable interest.

**Example**

*Kelly has held a $100,000 term life insurance policy for a short period of time. She has failed to disclose that she visits a cardiologist approximately three times a year because of a heart problem. If the insurance company becomes aware of her visits to the cardiologist, the life insurance contract may be terminated.*

**Cancellation of contract**

Cancellation means that the contract is cancelled based on present circumstances, without questioning the policy since it was in effect.

Three events or circumstances may cause the cancellation of the contract:

- Non-payment of premiums
- An attempt to end the insured’s life
- Cancellation without cause by policy holder

**Example**

*Kelly did not pay her last two monthly premiums. The insurer has the right to cancel the life insurance contract.*
5. **Assessing Life Insurance Needs**

We all understand that it is not possible to assign a value to a person’s life. It is, of course, invaluable. As a Life Insurance Agent, one of your tasks is to determine a suitable amount of life insurance for your clients. The process of accomplishing this task is called a needs analysis. Discussed below, are some of the key tools used to assess the life insurance needs of your clients.

**Budget**

A budget is a process used to determine the amount of money that can be spent and how it will be spent. It is instrumental in assisting a client with achieving his financial goals. A budget is a comparison of income sources with fixed, variable, discretionary and non-discretionary expenses. This tool is used to assist the client and the Life Insurance Agent in determining whether the client has sufficient cash flow to pay the premium on an insurance policy.

**Balance Sheet or Personal Balance Sheet**

A balance sheet is a snapshot of the client’s financial situation; it compares his assets with liabilities. The difference between the two is called the client’s net worth.

There are three main categories of assets: liquid assets, income-producing and personal property. There are two main classes of liabilities: current liabilities, which are debts to be paid within one year, and long-term liabilities, which are debts to be paid after more than one year.
Assessing the client’s situation

Personal information

The consumer must be assured that any information gathered by the Life Insurance Agent is kept confidential. The Life Insurance Agent must at all times put the needs of the client first and comply with the rules and regulations of the insurance regulator(s).

Several factors have an impact on the client’s current situation, such as:

- Gender (women live longer than men)
- Age
- Smoking status
- Job-related risks
- Discretionary income
- Regularity of income
- Duration of income needs
- Ages of dependents

Example
A 34 year old man who works on contract as a lineman at Hydro-Québec and has 5 children between the ages of 2 and 8 does not have the same life insurance needs as another 34 year old man who works as a tax lawyer for the government, is married to a radiologist and neither has any children.

Financial Goals

Financial goals are the foundation of a financial plan. Individuals write financial goals and then prepare a budget in order to achieve their goals. Goals can be written to cover a variety of time frames however it is most common to prepare financial goals that cover the following different timeframes:

- Short-term: Covers plans for the next year
- Medium term: Covers plans for the next five years
- Long term: Covers plans extending beyond five years

Example
Frank wants to replace his car next May (short term), wants to move to a larger home in four years (medium term), and retire in 30 years on an after-tax income of $60,000 / year (long term).
Identifying the client’s specific needs

In the process of assessing the client’s needs, some of the following critical questions will be answered:

- How much money does he want to leave to his spouse and/or children in the short term?
- How much money does he want to leave to his spouse and/or children in the long term?
- Will the surviving spouse continue to work?
- How long will it take his children to become financially independent?
- Does he want all his debts re-paid at death?
- What are his tax liabilities at death?

The answers to these questions will help determine the level of insurance required / desired by the client.

Recommending a Solution

How much?

The evaluation of the client’s financial situation and his answers to the above questions will assist the Life Insurance Agent in determining the amount of insurance a client needs.

For how long?

The coverage period is directly related to the client’s needs. To meet short-term needs, such as the time it takes for children to become independent or the time needed to repay a mortgage, term insurance coverage is usually the most appropriate and cost effective.

To meet long-term needs, permanent life insurance, such as whole life or universal life insurance should be considered. Long-term needs such as leaving an inheritance, paying funeral costs, or paying the tax liability on a vacation property, are satisfied with permanent insurance.
6. Accident and Sickness Insurance

It is said that an individual’s greatest asset is his ability to work and to receive payment (e.g., salary, wages, or commissions) for that work. The inability to work due to an accident or an illness (sickness) and the resulting loss of wages (salary, or commissions) will hinder or prevent clients from reaching their financial goals. These disabilities may last weeks or, in some cases, years. For the purposes of this guide we will not go into detail on the various types of accident and sickness insurance coverage however the following is a list of the types of coverage most often found in accident and sickness insurance:

- Short-term wages;
- Long-term wages;
- Medical expenses;
- Accidental death;
- Accidental dismemberment;
- Eye care;
- Healthcare professional fees; (physiotherapist, massage therapist…)
- Dental care;
- Medical assistance;
- Travel.
7. **Individual (Private) Disability Insurance**

The processes an insurer takes along with the various types of coverage which may be purchased by clients are the subject of this section.

**Risk Selection**

**Insurability**

Several factors must be considered when evaluating the risk of disability for a given worker, including:

- Health status
- Medical and family history
- Lifestyle
- Occupational class
- Place of work
- Engaging in dangerous or extreme leisure activities
- Place of residence
- Age
- Gender, and
- Earned income

**Occupational risks**

*Work environment*

A waitress working in a topless bar is exposed to greater risk than a waitress working in a shopping centre.

*Duties*

Workers in the construction industry are more exposed to risk than financial planners.

*Job stability*

A salesperson that changes employers frequently is more difficult to insure than an accountant who has been in the same government position for more than 15 years.
Medical risks

Past medical history

For an insurer, a person who is overweight and whose parents both died of heart disease before the age of 60 represents a greater risk than a person who works out three times a week and whose parents died at the age of 85.

Similarly, a person who has already had a heart attack is a greater risk than a person with a spotless medical history.

Managing the risk

Insurers use a variety of measures to optimize management of the risks represented by individuals.

Reduction in the benefits or benefit period

The insurer may reduce the benefit amounts or shorten the benefit payment period to avoid charging an additional premium, taking into account the person's medical history.

Extension of the elimination period before the first benefit payment

For minor health problems such as skin conditions, an extension of the elimination period before the first benefit payment reduces the insurer's risk of having to pay benefits to persons with minor or mild conditions.

Additional premium

Additional premiums are required from persons whose health status increases the probability of illness or accidents for which risks cannot be excluded.

Exclusions

Exclusion riders allow insurers to insure individuals who otherwise would not be insurable due to their health status. For example, an individual with respiratory problems due to asthma may be accepted by an insurer, but with an exclusion rider for asthma.

Over insurance

One of the major principles of disability insurance is that an individual with a disability contract must not be paid more during a disability period than when working.
Coordinated benefits

A disability benefit amount paid out may be lower than the amount specified in the disability insurance contract. This occurs when the contract has a coordination of benefits clause. With this type of clause, the benefit amounts are reduced by benefits received from other sources (other disability insurance coverage).

Cancellable Contracts

Of the three contract types, the cancellable contract is the one that provides the least coverage. The insurer may change the premiums and coverage at any time, hence the name.

Guaranteed Renewable Contracts

Guaranteed renewable contracts (contracts with a guaranteed renewal) are an intermediate product between cancellable contracts and guaranteed irrevocable contracts in terms of both benefits and premium costs.

With a guaranteed renewable contract, the insurer cannot change the coverage in the contract nor refuse to renew the contract as long as the insured pays the premiums, is a Canadian resident, and holds a job deemed satisfactory by the insurer.

The insured person must notify the insurer of any change in situation under this type of contract.

Guaranteed Irrevocable Contracts

A guaranteed irrevocable (non-cancellable) contract is the contract type that offers the best coverage. The premiums are of course higher than with the other two contract types.

If the insured person makes the premium payments as required under the contract, the insurer may not change the contract (neither the premium nor the coverage).

Even if the insured person changes profession or place of residence, or has a decrease in income or deterioration in health, he/she is not required to notify the insurer, and the coverage is maintained as it was when the contract was signed.
Optional Coverage’s

Optional coverage’s are used to complete basic individual disability insurance coverage.

**Premium reimbursement coverage**

Premium reimbursement coverage allows the insured person to receive a reimbursement of all or part of the premiums paid to the insurer if no claims have been filed during the qualifying period.

**Hospitalization coverage**

Hospitalization coverage provides additional coverage if the insured person must be hospitalized for at least 24 hours due to illness or injury.

**Partial disability coverage**

Partial disability coverage protects individuals who lose part of their income if they are unable to work full time at their jobs.

This coverage takes effect if the insured person cannot perform 50% or more of his/her regular work duties or is unable to devote 50% or more of the time normally spent working.

**Residual disability coverage**

Residual disability coverage protects individuals who lose part of their income due to disability. To qualify, the insured person's loss of income must normally be between 20% and 80% of the normal income amount.

**Cost of living coverage**

Cost of living coverage protects the insured person's purchasing power by increasing benefits to offset the effects of inflation.

**Health care profession rider**

The health care profession rider protects insured persons who may no longer be able to work due to a condition such as hepatitis B or C, or HIV.
Accidental death or dismemberment coverage

In the event of accidental death

Accidental death or dismemberment coverage provides for the payment of a lump sum to the insured person's estate if the insured person dies as a result of an accident. Usually, an amount of $10,000 per $100 of monthly benefits is paid.

Example
If the monthly benefit is $1,000, the lump sum may be $100,000.

The amount received under this coverage must not exceed the limits set out in the contract.

In the event of accidental dismemberment

Accidental death or dismemberment coverage provides for the payment of benefits to a person who has lost the use of limbs or faculties as a result of an accident. Dismemberment can mean the loss of use or total severance of a limb.

Reduced elimination period

The reduced elimination period option provides for a reduction in the elimination period in the event of an accident or hospitalization due to illness.

Regular occupation extension until the age of 65

The regular occupation definition is the one used in basic contracts. During the first 24 months of a disability, the definition of total disability makes reference to the regular occupation. After this 24-month period, the definition of total disability refers to the individual's inability to engage in gainful employment relating to his or her training, education or work experience.

Insured persons are entitled to the extension option until the age of 65 if they have no other income, receive care from a physician following an accident or illness, and cannot perform the main duties of their regular occupation.

Future insurability guarantee

The future insurability guarantee allows for future increases in disability coverage without proof of health status or occupation. This guarantee allows for supplementary coverage to be added to the basic coverage, provided that the insured person can prove that he or she has the insurable income required for the benefit increase.
8. **Group Disability Insurance**

Insurance can be purchased individually or as a group. We will discuss the different disability policies available for group insurance.

**Business group insurance**

Business group disability insurance is part of a benefits plan that is also called group insurance. Eligible employees must normally join the group disability insurance plan.

For group insurance to be in force, a group of insured persons must be established along with the conditions that qualify the group.

**Example**

*Full-time employees of DFG Inc. who work more than 25 hours a week for the company may meet the two eligibility requirements for this company's group insurance plan.*

**Participation**

The insurance certificate issued to the insured person confirms enrolment in the employer's group plan.

To enrol in a group insurance plan without evidence of insurability, one must do so within 30 days of becoming eligible for the plan.

**Management**

Contract management is facilitated by the fact that the employer holds much relevant information on its employees and is best positioned to manage the contract.

**Definition**

In order for a disability to be accepted, it must be total, and the insured person must not receive work income except from rehabilitation programs recognized by the insurer and must receive care from a health care professional on a regular basis.

**Short-term group disability insurance coverage**

**Benefits**

The benefits are normally two thirds of remuneration with a set maximum amount.

Benefits are paid weekly and the benefit period is usually 15 to 26 weeks (one half year).
The elimination period

The elimination (or waiting) period before the first benefit is paid is quite short, from 0 to 15 days.

Long-term group disability insurance coverage

Exclusions and restrictions

The following exclusions and restrictions apply to both short-term and long-term coverage:

- Injury or illness resulting from an assault or criminal act;
- Leave taken to receive aesthetic care;
- Attempted suicide;
- Self-inflicted injury;
- Accidental injury or illness occurring during a temporary layoff, lockout or strike, if the member's coverage has not been maintained during the layoff, lockout or strike;
- Injury or illness due to participation in a riot, war, civil unrest or uprising.
- If a plan member is under treatment for drug dependence or alcoholism, the insurer may agree to provide coverage.

Pre-existing illnesses

The insurer may decide to exclude pre-existing illnesses from disability insurance if the group to be insured does not already have such coverage at the time of the agreement.

This exclusion cannot be made when changing insurers upon the expiry of a contract (as members of the former plan have acquired privileges).

Group plan taxation

An employer which sets up a group insurance plan rather than individual policies for employees will have tax benefits:

- The premiums are deductible for the business;
- The premiums are not a taxable benefit for the employee;
- The benefits are taxable for the employee.

Premiums paid by the employee

With consolidated disability insurance contracts where the employee pays the premiums, the benefits paid in the event of disability are not taxable.
If the employer pays a portion of the premiums, the employee will be taxed on the portion of the benefits that exceed the portion paid by the employee.

**By health and welfare trust**

Employers can also set up a health and welfare trust that will own the disability insurance contracts on behalf of employees.

The tax benefits of a health and welfare trust are similar to those of a group plan and are summarized as follows:

- The premiums are deductible for the business;
- The premiums are not a taxable benefit for the employee;
- The benefits are taxable for the employee.

**Association Group Insurance**

Association group insurance is intended for members of associations rather than businesses.

**Example**

Accountants may obtain association insurance through an agreement between their professional association and an insurer.
9. **Business Disability Insurance**

Along with offering coverage to their employees, certain employers may also consider protecting their business in the event of a disability. These disabilities may be of an employee or a business owner. As the insurance is linked to and for the purposes of maintaining a business, it is referred to as business disability insurance.

**Key person coverage**

Key person coverage protects businesses from financial losses that may result from the disability of key persons in an organization.

There is normally a 30-day elimination period before the first benefit is paid. The benefits are normally received for 12 months, and the benefit may be doubled if the business expects that it will have to replace the key person.

**Example**

*DESR Inc. purchases key person insurance coverage and asks to receive $8,000 rather than $4,000 in the event that its key person becomes disabled.*

*Premiums depend of course on the amount of coverage.*

**Disability buy-out coverage**

Disability buy-out coverage protects businesses from the long-term disability of a partner (owner). It allows the disabled partner's shares to be bought out over a long period. The buy-out is accomplished through periodic payments or a lump-sum payment.

**Overhead expense coverage**

Overhead expense coverage allows for the reimbursement, up to a certain limit, of the expenses incurred by a business to continue providing services if the owner becomes disabled.

This coverage is intended in particular for small businesses with a sole owner or key person. To be eligible, this person must work full time for the business.
Expenses covered up to the maximum set out in the contract include:

- Wages of employees who perform different duties than the insured;
- Rent;
- General insurance costs;
- Professional or union dues;
- Telephone service;
- Mailing costs;
- Laundry;
- Electricity and heating;
- Water;
- Mortgage payments;
- Property taxes;
- Equipment rentals; and
- Legal and accounting fees.

The expenses that are not covered include:

- Travel and entertainment expenses;
- Costs of purchasing goods for resale;
- Income of the insured person or a person who performs the same work as the insured person;
- Equipment and vehicle operating costs;
- Expenses incurred to generate business income while the insured is disabled; and
- Expenses incurred by the insured person after the disability has ended.
10. Critical Illness Insurance

Critical illness insurance enables individuals who are diagnosed with a critical illness to receive a lump sum that will help them to better manage the financial and human consequences of their condition.

The loss of income that results from critical illness and increasing health care costs are both important reasons for purchasing this type of coverage.

Coverage

Critical illness insurance provides benefits to insured people whether they are able to work or not.

Premium reimbursement upon death

This clause provides for the reimbursement of premiums if the insured person dies before the end of the elimination period.

Benefit paid

The maximum benefit is based on the insured person's income. Critical illness insurance coverage pays an amount that is a multiple of the insured person's wages. The maximum amount may exceed $1,000,000.

If the insurance is used as disability buy-out coverage, the highest benefit amount will be the market value of the insured person's share in the business.

If the insurance is used as disability buy-out coverage, insured persons who own more than 10% of the business must have coverage in proportion to their share in the business.

Example

CVB Inc. is worth $200,000 and the insured person, who has critical illness insurance, holds 50% of the shares, or $100,000.

Risk Selection

The insurer considers a number of factors before agreeing to insure an individual against critical illness. The main factors include the individual's health condition, medical history, family history, lifestyle, profession and financial situation.
Elimination period

The elimination period before the lump-sum benefit is received is usually 14 or 30 days. To receive the benefit, the insured person must survive the elimination period.

Free use of benefit

Insured persons may use the lump-sum benefit from the insurer for whatever purpose they see fit.

Optional Coverage

Among the optional coverage used to supplement basic critical illness insurance, two in particular are offered most frequently. These options are presented below.

Premium reimbursement

With the premium reimbursement coverage, premiums paid can be refunded as follows:

- At 75 years of age, if a critical illness insurance contract has been bought until age 75 and no claim has been made;
- Upon the death of the insured person if it occurs before the end of the elimination period;
- Upon the death of the insured person if it occurs after the end of the elimination period, and the insured person has not made any critical illness claims.

Waiver of premiums

Waiver of premium coverage allows policyholders to stop paying premiums if they become disabled.

Main Illnesses Covered

Cancer

For the insurer, cancer is defined as the invasion of tissue, spread of malignant cells and uncontrolled growth of a tumour.

Heart attack

Heart attack is defined as the acute presentation of heart symptoms with death of part of the heart muscle and inadequate blood supply.
**Cerebrovascular accident**

A cerebrovascular event producing neurological trauma and caused by thrombosis, embolism from an extra cranial source, or intracranial hemorrhage.

**Loss of speech**

Loss of speech is defined by damage to the vocal cords that is sufficiently serious to result in total and irreversible loss of the ability to speak.

**Deafness**

Deafness means the irreversible loss of hearing in both ears. The auditory threshold for each ear must be 90 decibels or greater at frequencies of 500, 1,000 and 2,000 hertz.

**Blindness**

A diagnosis of blindness must be made by an ophthalmologist. Blindness is the irreversible loss of vision in both eyes with the field of vision being less than 20 degrees in each eye and corrected visual acuity being less than 20/200 in each eye.

**Coma**

A coma is a state of continuous unconsciousness lasting four days with no reaction to external stimuli or internal bodily needs.

**Severe burns**

Burns must be medically diagnosed and cover at least 20% of the body surface.

**Paralysis**

A result of trauma to the nervous system, paralysis is the total loss of voluntary movement in both legs, or both arms, or one leg and one arm.

**Kidney failure**

Kidney failure is defined as irreversible failure of both kidneys. As a result of this failure, a kidney transplant, peritoneal dialysis or regular hemodialysis must be considered and undertaken.

**Major organ transplant**

The organ transplant must be carried out and be medically essential. The major organs referred to are the heart, lungs, bone marrow, liver, pancreas and kidneys.
**Parkinson's disease**

The insured person must be unable to perform two of the following six daily activities:

i. Mobility: move 10 metres without assistance  
ii. Dressing: dress and undress by oneself  
iii. Drive a vehicle  
iv. Toileting: able to take care of one's personal hygiene  
v. Eat  
vi. Stand up and sit down

**Alzheimer's disease**

Alzheimer's disease is recognized if the insured cannot live alone, requires at least eight hours of daily supervision and experiences progressive deterioration of memory and cognitive abilities, in accordance with the *Diagnostic and Statistical Manual of Mental Disorders*.

**Multiple sclerosis**

A multiple sclerosis diagnosis must be confirmed by a neurologist. There must be objective evidence, supported by investigative and imaging techniques, of lesions at more than one site in the central nervous system.

**Coronary artery bypass**

Coronary artery bypass refers to surgery required to correct the narrowing or blockage of one or more coronary arteries.

The definition does not include laser correction of a blocked artery.
### Taxation of Critical Illness Insurance.

<table>
<thead>
<tr>
<th>Group plan</th>
<th>Owner</th>
<th>Beneficiary</th>
<th>Premiums</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical illness insurance is part of a health or accident insurance plan</td>
<td>Corporation</td>
<td>Employee</td>
<td>Federal: Non-taxable benefit for the employee; Provincial: Taxable benefit for the employee</td>
<td>Non-taxable</td>
</tr>
<tr>
<td>Group plan</td>
<td>Employee</td>
<td>Employee</td>
<td>Non-deductible; and No tax credit</td>
<td>Non-taxable</td>
</tr>
<tr>
<td>Critical illness insurance is part of a health or accident insurance plan</td>
<td>Corporation</td>
<td>Corporation</td>
<td>Non-deductible for the corporation; Non-taxable for the employee</td>
<td>Non-taxable</td>
</tr>
<tr>
<td>Individual insurance</td>
<td>Corporation</td>
<td>Employee</td>
<td>Deductibles for the corporation; Taxable for the employee</td>
<td>Non-taxable</td>
</tr>
<tr>
<td>Individual insurance</td>
<td>Individual</td>
<td>Individual</td>
<td>Non-deductible; No medical expense tax credit</td>
<td>Non-taxable</td>
</tr>
</tbody>
</table>
11. Introduction to Investing

Elements Linked to Financial Products

Before investing in various financial products, we must first ask ourselves about the purpose of the objective. Then we must make a choice among many products allowing us to achieve this goal. To do so, we must study various features describing these products.

Security

Security refers to capital protection and the fact that the initial amount invested will be recovered.

Example

John and Jenny would like to build a residence next summer. Capital protection is important and they want to avoid any unexpected sudden drop in the market that would lower their down payment for achieving their real estate dream.
**Liquidity**

A financial product is considered liquid when it is possible to quickly recover the money invested when you decide to sell.

**Example**

*Max has purchased a mortgage investment in mutual funds 3 years ago. He decided to redeem his investment and received the full redemption in 3 working days.*

**Return and Type of Income**

Return is the increase in value of a financial product. Return involves three types of income from investments.

*Interest income*

This represents the return on the money loaned. We can compare it to an apartment that you are renting to a tenant; the latter must pay you rent while he is staying in the apartment.

Interest income is fully taxable, the same as employment income.

*Dividend income*

Dividend income is a portion of the profit earned by a corporation that is distributed to the corporation's shareholders.

Canadian dividend income is subject to a preferential tax treatment.

*Capital gains or losses*

A capital gain is realized when property is sold at a price which is higher than its purchase price.

A capital loss is realized when property is sold at a price which is lower than its purchase price.

Capital gains have an inclusion rate of 50%, which means 50% of any realized gains will be added as taxable income.

**Example**

*Micahel purchases a stock fund for $5,000 and sells it for $7,000. His capital gain is $2,000, $2000 X 50%= $1000 will be added to Michael’s income.*
**Risk**

Return and risk are very closely related.

A financial product that provides an anticipated high return has a high risk.

A financial product that provides an anticipated low return has a low risk

*Risk related to liquidity*

An investment can be difficult to buy or sell when there are few purchasers or sellers for this investment.

*Risk related to politics*

Political instability drives away capital money and investors.

Capital money investors look for political stable countries. A country at war does not attract investors.

*Risk related to business*

A corporation runs risks that could jeopardize its survival, like a sudden drop in the price of pork for a business involved in the pork trade.

*Risk related to interest rate*

When interest rates increase, interest bearing investments recently issued have better rates compared to those issued earlier. The earlier interest bearing investments will have a lower market value.

*Risk related to exchange rate*

The value of investments depends on upward and downward exchange rates movements at the level of foreign currency.

*Risk related to lack of liquidity and to insolvency*

A corporation may have difficulty repaying capital and interest owing on its loans. This illustrates the risk related to lack of liquidity and to insolvency.
Risk related to inflation

Purchasing power is reduced by the cost of living and inflation. Inflation is the increase in the cost of living.

An investment that generates a gross yield of 5% with a 2.5% inflation rate provides a net yield of 2.5% before taxes.

Ease of management

Ease of management is the time and effort an investor spends to follow-up on the investments progress.
12. Debt Securities

Debt securities are contracts between a borrower and an investor; the investor lends a sum of money to the borrower. As is all loan transactions, the interest is paid by the borrower. Therefore it is understood that when an investor receives interest for money “invested” he has entered into a debt security with his money.

Guaranteed Investment Certificates

Guaranteed deposits, also known as Guaranteed Investment Certificates (GIC) are issued by financial institutions such as banks, credit unions and insurance companies among others. They are for a fixed period of time, and usually have a fixed interest rate they will pay.

Money Market Securities

Treasury bills, banker’s acceptance and commercial paper are part of the money market securities where debt securities are traded in 1 year or less.

Treasury bills are issued by the Federal and Provincial governments when short-term liquidities are needed. They are issued frequently up to several times per month. Bankers’ acceptances and commercial paper are issued by corporations when short-term liquidities are needed. The number of new issuances varies and is based on economic conditions and interest rates levels.

All three are purchased at a “discount” and sold for their “real” value (also known as nominal value or face value).

Here is an example to illustrate this statement.

Example

Nancy purchased a T-Bill that will be worth $10,000 in 1 year. She writes a cheque for $9,891.20 to purchase the T-Bill. The difference between the initial amount invested of $9,891.20 and the final value of $10,000 constitutes this T-Bill return of 1.10%.
Canadian Saving Bonds

<table>
<thead>
<tr>
<th>SAVINGS BONDS</th>
<th>FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by the Federal Government</td>
<td>RETURN</td>
</tr>
<tr>
<td>Loan granted by an investor to a</td>
<td>Relatively low</td>
</tr>
<tr>
<td>government</td>
<td>Interests payments</td>
</tr>
<tr>
<td>Typical maturity varies between</td>
<td></td>
</tr>
<tr>
<td>8 to 10 years</td>
<td></td>
</tr>
<tr>
<td></td>
<td>LIQUIDITY</td>
</tr>
<tr>
<td></td>
<td>Very high</td>
</tr>
<tr>
<td></td>
<td>Generally, they can be</td>
</tr>
<tr>
<td></td>
<td>reimbursed at any time</td>
</tr>
<tr>
<td></td>
<td>RISK</td>
</tr>
<tr>
<td></td>
<td>Very low</td>
</tr>
<tr>
<td></td>
<td>They are guaranteed by</td>
</tr>
<tr>
<td></td>
<td>the issuing government</td>
</tr>
<tr>
<td></td>
<td>MANAGEMENT</td>
</tr>
<tr>
<td></td>
<td>Easy</td>
</tr>
</tbody>
</table>

Bonds

<table>
<thead>
<tr>
<th>BONDS</th>
<th>FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by governments and corporations</td>
<td>RETURN</td>
</tr>
<tr>
<td>Loan granted by an investor to the</td>
<td>In general, interest is paid at a fixed rate</td>
</tr>
<tr>
<td>issuer</td>
<td>Possibility of a capital gain or loss if sold on secondary market prior to maturity</td>
</tr>
<tr>
<td>Maturity varies between 1 and 30</td>
<td>Possibility of additional gain if the security is convertible</td>
</tr>
<tr>
<td>years</td>
<td></td>
</tr>
<tr>
<td></td>
<td>LIQUIDITY</td>
</tr>
<tr>
<td></td>
<td>Low to high, depending on the borrower</td>
</tr>
<tr>
<td></td>
<td>They are covered by guarantees</td>
</tr>
<tr>
<td></td>
<td>From “Easy” to “High”, depending on the borrower</td>
</tr>
</tbody>
</table>

Bonds issued by governments are guaranteed by the governments’ taxation power.

Bonds issued by corporations are guaranteed by property. If a corporation is no longer able to pay interest owing on the borrowed capital, the bond holders become creditors with the authority to seize property in order to recover the sums owing to them.
# Debentures

<table>
<thead>
<tr>
<th>DEBENTURES</th>
<th>FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by corporations</td>
<td>Payment of interest generally at a fixed rate</td>
</tr>
<tr>
<td>Loan granted by an investor to the issuer</td>
<td>Possibility of a capital gain or loss if sold on secondary market prior to maturity</td>
</tr>
<tr>
<td>Maturity varying between 1 and 30 years</td>
<td>Possibility for other gains, if the bond is convertible</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>RETURN</th>
<th>LIQUIDITY</th>
<th>RISK</th>
</tr>
</thead>
<tbody>
<tr>
<td>From very liquid to not very liquid, depending on the borrower</td>
<td>Low to high</td>
<td></td>
</tr>
<tr>
<td>They can be bought and sold through securities dealers</td>
<td>They are not covered by any specific guarantee</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MANAGEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>“moderate ease of management”</td>
</tr>
</tbody>
</table>

Debentures are similar to marketable bonds but do not offer any specific guarantee.
13. Equity Investments

Equity investments allow for the investor to become an owner or stake holder in the business. Unlike debt securities, the investor no longer has a guaranteed return interest rate on the amount invested.

Preferred Shares

<table>
<thead>
<tr>
<th>PREFERRED SHARES</th>
<th>FEATURES</th>
<th>LIQUIDITY</th>
<th>RISK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by corporations</td>
<td>RETURN</td>
<td>From liquid to not very liquid</td>
<td>Medium to high</td>
</tr>
<tr>
<td>The investor holds an ownership interest in a corporation</td>
<td>Dividend income, normally fixed</td>
<td>They can be bought and sold on the stock market, through securities dealers or over-the-counter</td>
<td>Their market value tends to behave like that of debt securities</td>
</tr>
<tr>
<td>Priority over common shareholders with respect to dividends</td>
<td>Possibility of a capital gain or loss</td>
<td></td>
<td>MANUFACTURER</td>
</tr>
<tr>
<td>Preferred shares have no maturity date</td>
<td></td>
<td></td>
<td>From “Easy” to “High”, depending on the issuer</td>
</tr>
</tbody>
</table>

Voting Right

Preferred shares carry no voting rights. However, if the corporation has not paid scheduled dividends in the last quarter or during the previous year, preferred shareholders may have voting rights.
**Common Shares**

<table>
<thead>
<tr>
<th>COMMON SHARES</th>
<th>FEATURES</th>
<th>RETURN</th>
<th>LIQUIDITY</th>
<th>RISK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by corporations</td>
<td>The investor holds an ownership interest in a corporation</td>
<td>Possibility of dividend income</td>
<td>From very liquid to not very liquid</td>
<td>Medium to high and very high</td>
</tr>
<tr>
<td>The investor holds an ownership interest in a corporation</td>
<td>Generally carry the right to vote</td>
<td>Possibility of a capital gain or loss</td>
<td>They can be bought and sold on the stock market, through securities dealers or over-the-counter</td>
<td>Their holders are entitled to shares in the remaining assets of the corporation if it is wound up</td>
</tr>
<tr>
<td>No maturity</td>
<td></td>
<td></td>
<td></td>
<td>They are affected by the stock market fluctuations</td>
</tr>
</tbody>
</table>

**Voting Right**

Each ordinary share entitles to a voting right. It allows the holder to elect the directors of the company and to participate in the company’s major decisions.

**Mutual Funds**

<table>
<thead>
<tr>
<th>MUTUAL FUNDS</th>
<th>FEATURES</th>
<th>RETURN</th>
<th>LIQUIDITY</th>
<th>RISK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to better returns</td>
<td>Interest income and/or dividend income and/or Capital gain or loss depending on the securities in the portfolio.</td>
<td>Very liquid</td>
<td>Very low to high, depending on the securities in the portfolio.</td>
<td>No guarantee.</td>
</tr>
<tr>
<td>No maturity</td>
<td></td>
<td>Normally redeemable at any time</td>
<td></td>
<td>MANAGEMENT</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>“Easy”</td>
</tr>
</tbody>
</table>

A mutual fund is a portfolio of securities’ pool managed by a team of professionals.

**Diversification**

Instant diversification is an important advantage of mutual funds. In fact a mutual fund invests in several dozen securities at the same time and provides diversification at an affordable cost.
**Portfolio Management**

Mutual funds’ objectives dictate the portfolios composition or the combination of debt securities, equity securities or derivatives products managed by professionals in charge of the money representatives collected from investors.

The professionals managing mutual funds decide of the time to purchase and to sell securities that make up portfolios.

**Segregated Funds**

<table>
<thead>
<tr>
<th>SEGREGATED FUNDS</th>
<th>FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract between an investor and an insurer</td>
<td>RETURN</td>
</tr>
<tr>
<td>Assets held by an insurer separately from its other assets, hence the term “segregated funds”</td>
<td>Interest income and/or Dividend income and/or Capital gain or loss depending on the securities in the portfolio.</td>
</tr>
</tbody>
</table>

Segregated funds are offered by life and health insurance companies. Monies invested in the fund are pooled and kept separate from the insurer’s other assets and cannot be used for any other purpose than the benefit of segregated funds contract holders (not owners). A segregated fund is an Individual variable insurance contract.

**Fees**

Management fees of segregated funds are higher than management fees of a comparable mutual fund as they offer additional features and guarantees. These distinct features are: exemption from seizure, guarantee at death or at maturity of the contract and reset option.

**Exemption from seizure**

The exemption of segregated funds from seizure is possible because they are insurance products and not securities and an appropriate beneficiary was designated.
Guarantee at death

The guarantee at death provided by a segregated fund may vary between 75% and 100%.

Guarantee at maturity

The guarantee provided by a segregated fund must be at least 75% of the invested capital at maturity of the contract (and at death). It can be 100% with higher management fees.

This maturity date must be at least 10 years after the contract is taken out.

The reimbursement guarantee of the contract is only valid at maturity.

Example A

Damien purchased a $10,000 segregated fund on February 8, 2000. The contract maturity is 10 years with a 75% guarantee. On June 12, 2008, Damien requested full redemption of his segregated fund, which was then worth $6,800. He received $6,800 and not $7,500 (75% of $10,000) as he did not wait for the 10 year maturity period of the contract.

Renewal or Reset

Several insurers offer the possibility to renew the guarantee. Renewal is similar to update or reset of the segregated fund market value following an attractive increase of the fund value since the contract was taken.

Example

Diane invested $15,000 in a segregated fund on June 12, 2008. This fund’s guarantee is 75% of the amount invested and the maturity is 20 years. On April 16, 2012 the segregated fund is worth $18,755 and she decides to restart her fund guarantee. The new maturity date of the contract is April 16, 2032 and the amount guaranteed is now based on $18,755.

Maturity

The maturity date must be at least 10 years after the renewal.
Types of Funds

Money Market Funds

Money market funds also called money market securities funds are made up mostly of Treasury Bills, Banker’s acceptance, commercial papers and short term government bonds (less than 1 year).

Mortgage Funds

Mortgage Funds are made up of first-ranking mortgages on first-ranking residential buildings.

The risk is lower than that of bond funds as the term of a mortgage is often shorter than that of marketable bonds.

Bond Funds

Bond Funds are made up of mid to long-term bond debt securities.

Balanced Funds

Balanced Funds are made up of both fixed-income securities (bonds) and variable income securities (shares). We frequently hear about half and half, referring to fixed-income content and variable income content close to 50% in each case.

Dividend Funds

Dividend Funds are made up of preferred and common shares which pay dividends. Portfolio growth is a secondary goal compared to the regularity of dividends payment.

Equity Index Funds

Equity index funds reproduce a market index and are made up of large corporations’ common shares, which pay dividends; but the payment of dividends is not mandatory.

Large-cap Equity Funds

Large-cap equity funds are made up of common shares of large capitalization companies, which pay dividends but the payment of dividends is not mandatory.

The return potential is slightly higher to that of the index equity fund.
**Mid-cap Equity Funds**

Mid-cap equity funds are made up of common shares of mid-capitalization companies, which pay dividends but the payment of dividends is not mandatory.

**Small-cap Equity Funds**

Small-cap equity funds are made up of common shares of small capitalization companies, which pay dividends but the payment of dividends is not mandatory.

**Specialized Funds**

Specialized funds are made up exclusively of securities in a single sector. They concentrate on a single sector. They may invest, among others, in high technology, natural resources, health care or even income trusts.

**Segregated Funds Volatility from the lowest to the highest:**

<table>
<thead>
<tr>
<th>Risk</th>
<th>Expected Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Market Securities Funds <em>(fixed value)</em></td>
<td></td>
</tr>
<tr>
<td>Mortgage Funds <em>(less risk than the Bonds Funds)</em></td>
<td></td>
</tr>
<tr>
<td>Bonds Funds</td>
<td></td>
</tr>
<tr>
<td>Balanced Funds <em>(the most diversified funds)</em></td>
<td></td>
</tr>
</tbody>
</table>
| Index-linked Equity Funds | +
| Equity Funds | +
| Small-cap Equity Funds | +
| Specialized Funds | +
| | |
**Front-end Fees (acquisition)**

Front-end fees are fees to be paid when purchasing segregated funds. Also called subscription or purchase or front load fees and represent a percentage of the amount invested.

**Example**

An investor invests $5,000 in a dividends segregated fund with 2.5% front-end fees. Therefore 97.5% of $5,000 is actually invested.

**Back-end load Fees (Retrocession Fees)**

Back-end load fees are fees to be paid when redeeming segregated funds. They are also called retrocession fees and represent a percentage of the amount invested.

**Example A**

An investor invests $5,000 in a dividends segregated fund without front-end fees and with decreasing retrocession fees on the market value over 6 years decreasing at the rate of 1% per year. The segregated fund has a market value of $6,000 in the 4th year whereas retrocession fees are 3% of the market value; i.e., $180.

**Transfer Fees**

Transfer fees occur when switching a segregated fund for another segregated fund of the same family.

**Management Fees**

Management fees, based on a percentage of the asset under management are charged by segregated funds for the work done by management teams as well as various administration fees.
14. **Annuity Products**

An annuity provides an individual with a regular income, usually periodic and constant over a fixed period of time. The biggest advantage of an annuity is the ease of management. The main disadvantage is that once the payments have started you cannot reverse the decision.

There are two main types of annuities: Immediate Annuities and Deferred Annuities.

**Immediate Annuities**

As its name implies, immediate annuities are paid immediately following the first period after the annuity contract is taken.

An immediate annuity is set-up in consideration for the lump sum of an amount as the full amount must be paid before the benefits can begin.

**Example**

*67 year old Francis takes out an immediate annuity on June 12, 2012 to receive $1,000 per month for the rest of his life. He pays $125,000 now to take out this annuity. The first annuity payment will be on July 12, 2012.*

It can also be said the annuity is in the payment phase

During the payment phase, the invested capital and the yield on the capital are returned in the form of payments. The variables and the manner in which the annuity amount is calculated must be specified in the annuity contract

There are two categories of immediate annuities:

**Annuity certain**

An annuity certain is an annuity of which the periodic are guaranteed for a certain number of years. The lifetime (life expectancy) has no impact on the periodic payments received.
**Life annuities**

Life annuities are immediate annuities providing periodic payments until the death of the annuitant. Life means “during the life time”.

*With guaranteed period*

The payment of benefits under a life annuity with a guaranteed period ceases upon the death of the annuitant when the death occurs after the end of the guaranteed period
Or
At the end of the guaranteed period, when the death of the annuitant occurs before the end of the guaranteed period.

*Without guaranteed period*

The payment of benefits under a life annuity without guaranteed period ceases upon the death of the annuitant.

*Joint Life and Survivor annuity*

Upon the death of the annuitant, the surviving spouse continues to receive payments. This is what a joint and survivor annuity provides. At the death of the surviving spouse (second death) payments will cease.

*Indexed*

The purpose of an indexed life annuity is to protect the annuitant against the ever increasing cost of living.

**Deferred Annuities**

As the name indicates, a deferred annuity allows for benefits to be made at a future date and not immediately after the contract has been taken out.

A deferred annuity is created either by paying a lump sum or by accumulating capital over time. The amount of money must be paid in full before the annuity benefits can start.

It can also be said that the annuity is in the capitalization phase
During the capitalization phase, the insurer grows the capital invested by the owner. The invested capital may be paid in a single amount or by periodic payments.

To constitute an annuity contract, there must be alienation of capital by the owner. This alienation entitles the owner to oblige the insurer to make periodic payments to the annuitant.
Annuity Contract

An annuity contract may involve up to five different parties:

i. **Owner (holder):** The owner is the contract holder. The contract belongs to him.
ii. **Annuitant:** The person for whose lifetime the annuitant is specified.
iii. **Payee:** The person who receives the benefits.
iv. **Beneficiary:** The person who inherits the balance of the annuity upon the death of the annuitant.
v. **Grantor of annuity (debtor):** The financial organization who is making the payments to the payee.

**Beneficiary designation**

The designation, which may either be revocable or irrevocable, of a beneficiary and annuitant may be done in a written document, will, or annuity contract.

A designation made in a will may always be revoked. Designating an annuity contract beneficiary means that the death benefit goes directly to the beneficiary without passing through the estate.
15. Legal Concepts

Clients are intrusting all those in the financial services industry. In order to ensure a certain standard is met by all those in the industry certain guidelines are set forth. These rules are what each representative must comply with and each client must understand.

Rules Governing the Representative's Activities

Financial advisers must behave ethically in their dealings with the general public, clients and insurers (companies offering insurance of persons).

Example

A representative may not guarantee that a client will receive any given return on a variable financial product. A representative who has acted in this manner to secure a client has failed to act honestly with the client.

Duties and obligations of financial advisers

To the profession

- A financial adviser who is under inquiry must refrain from contacting the person who requested the inquiry.
- A financial adviser who observes a colleague engaging in inappropriate conduct must notify the appropriate regulatory organization.

Example

You surprise a colleague drinking alcohol in his office while he is preparing to meet a client. You had seen the same colleague in the corridor a few minutes earlier and judging by his gait, he did not appear to be in a condition for meeting a client. Such behaviour must be reported.

- A financial adviser may not receive payment from individuals other than those who have asked to do business with him or her.
- A financial adviser may not pay a prospective client to do business with him or her.
- A financial adviser may not receive any compensation from a person who does not hold a licence but who acts as if he or she had one.
- A financial adviser may not pay a person as a representative if the person does not hold a representative's licence.
Example
A financial adviser who is assisted in telephone solicitations by a person who does not hold a licence cannot pay this person by sharing sales commissions. The adviser may compensate the person by paying wages or fees, but the source of the funds cannot be sales commissions.

- A financial adviser must act honestly at all times. No premium discounts for clients are acceptable, nor is any agreement to change the premium payment method stipulated in a contract.

To other financial advisers, independent partnerships, firms, financial institutions and insurers

- A financial adviser must remit the amounts collected for an insurer along with whatever information the insurer requires.

To the client

- A financial adviser must respect a client's decision to seek a second opinion on his or her financial situation.
- The adviser must also give back to a client any documents borrowed to work on the client's case, even if the prospect owes the adviser money.
- A financial adviser must respect the confidentiality of all documents and information received from clients. The use of these documents and information must not benefit the financial adviser to the detriment of clients.
- A financial adviser must demonstrate diligence and availability.

Example
A client calls her financial adviser twice in the same week, in addition to sending him an e-mail, because she wants to change the beneficiaries in her life insurance contract. The adviser has still not returned her calls after one week. This is a breach of ethics.

- A financial adviser may not conduct any transactions with clients who are unable to manage their affairs on their own.
- A financial adviser may not conduct transactions for a client if he or she acts as curator or dative tutor for the client.
- A financial adviser may not accept any assistance from a third party, which may be detrimental to a client.
- A financial adviser may not make personal use of securities that belong to clients.
- A financial adviser must have full knowledge of the facts before offering specific advice to clients. He or she must provide clients with accurate advice. If information is missing, the adviser must seek it out and refrain from offering any advice that may be mistaken or inaccurate.
A financial adviser must refrain from making misrepresentations to clients. He or she must demonstrate the pros and cons of the products and services offered to clients.

A financial adviser must respect his or her limits and knowledge when dealing with clients.

To the public

A financial adviser must avoid pressuring clients to sign contracts or accept suggested strategies.
The adviser must demonstrate moderation, objectivity, discretion and dignity.
A financial adviser must seek to educate and inform the public and promote the quality of services offered.

**Liability of Financial Advisers**

A financial adviser will be considered liable if the following three elements are found together: fault, damage or harm, and a relationship between the two.

**Fault**
A fault can be one of three types: non-intentional, intentional, or gross. Civil liability can occur with any of the three.

In cases of civil liability, the damage sustained must be repaired.

**Damage**
Harm or damage may be bodily (physical injury suffered by the victim), material (involving the victim's property), or moral (inconvenience suffered). The burden of proof lies with the victim.

**A causal link must appear between the fault and the damage.**

**Example**
*A financial adviser has a client add a critical illness coverage rider to a contract that already provides life insurance coverage. The client receives an invoice for administrative fees on a new contract. The adviser forgot to mention to the insurer that the critical illness coverage was to be added to the existing contract, not to a new contract. In this case there is harm to the client due to a fault by the adviser.*

**Civil liability**
Civil liability refers to the obligation to repair any injury caused to another person. The purpose of a civil liability suit is to receive financial compensation for harm suffered.
Criminal liability

Financial advisers will be criminally liable if they are found guilty of embezzlement, fraud or theft by a court under the *Criminal Code*. The case is prosecuted by the Crown Prosecutor.

Professional liability

Financial advisers who work for a firm without being employees of the firm must take out professional liability insurance that protects them in the performance of their duties and for a further five years after they cease their professional activities.

Ethical liability

Actions involving breaches of ethics do not lead to financial compensation (unlike civil liability suits). They instead lead to the levying of fines or removal of the financial adviser's right to pursue professional activities.

Protection of personal information

The following example is a good illustration of what is meant by protection of personal information.

Example

*An insured person makes a claim with a firm that offers credit and insurance services, and the claim includes information on the person's lifestyle and medical history. The financial adviser may not disclose the information that he knows about the insured. The adviser sends the claim to the insurer and keeps no copy of it.*

The insurer is not entitled to give a firm that offers credit and insurance services the information on the lifestyle and medical history of a client even if the client authorizes the insurer to do so.

Default of the Policyholder

Fraud

Fraud consists in providing misinformation or concealing information in order to influence the insurer's decision regarding an insurance contract.

If fraud is proven, the contract may be cancelled.
Example
A client meets a financial adviser and does not mention the fact that the year before he was accused of aggravated assault in a case of road rage, which caused him to lose his driver’s licence for five years.

Concealment

Concealment occurs when the policyholder's intention is not to mislead the insurer. It is an oversight or failure to declare information that the policyholder deems of little importance.

Example
A policyholder forgets to mention that he takes a prescription drug on a regular basis.

Concealment may lead to cancellation of the contract or a reduction in insurance coverage.

If the insured person dies more than two years after the effective date of the contract, the insurer is obliged to pay the face amount, unless fraud has occurred.

If the insured person dies less than two years after the effective date of the contract, the insurer may apply for cancellation of the contract and avoid having to pay the face amount.

Misrepresentation

Misrepresentation occurs when the policyholder provides false or inaccurate information to the insurer that may have an impact on the risk assessment.

Example
A policyholder tells his financial adviser that he saw his doctor five times in the last five years, when in fact it was five times a year because he has high blood pressure.

Misrepresentation may lead to cancellation of the contract.

Example
Serge declares that he did not take any illegal drugs in the year preceding the effective date of his insurance contract. In fact he took drugs at a party with friends two months earlier, and witnesses have confirmed the fact. Serge dies suddenly three months after the effective date of his contract.

The insurer is not obliged to pay the face amount because of the misrepresentation.
Conditions Necessary to Form an Insurance Contract

For an insurance contract to be valid, four conditions are required: cause, object, capacity and consent.

Cause

Cause is simply the reason for the contract. It justifies the contract and its existence. In the case of life insurance contracts, the premium is the cause of the contract for the insurer, while the death benefit is the cause for the policyholder.

Object

The object of the contract is the obligation to provide property or a service or an amount of money to respect the agreement between the parties. In the case of life insurance contracts, the benefit is the object of the contract for the insurer, while the premium is the object for the policyholder.

Capacity

Capacity refers to the legal capacity that both parties must have in order for the contract to be valid. Minors and incapable persons of full age are considered unable to exercise their civil rights and therefore unable to enter into a contract.

Minors

Minors need their tutor (mother or father) to take out an insurance contract, unless they are fully emancipated (through marriage or by court order).

Parents are also responsible for administering property received upon payment of an insurance benefit.

Consent

The consent of both parties is essential to forming a contract.

Consent may be tacit, that is through an act that demonstrates acceptance of the contract.

Example

*Jenny is offered a financial product and she responds by asking when she can meet with the person making the offer to purchase the product. The acceptance in this case is tacit, or implicit.*
Consent may also be express.

**Example**
*A financial adviser offers a client to pay his contribution to a retirement savings plan. The client accepts immediately and takes out his chequebook.*

Consent must be free and enlightened, thus it may not be the result of lesion, fear, fraud or error on the part of either party.

**Defect of consent: harm**

Harm involves the exploitation of one party by the other. Harm vitiates consent in the case of minors and incapable persons of full age under protective supervision (under a mandate given in anticipation of incapacity).

Minors and incapable persons of full age must prove that they have suffered prejudice.

**Defect of consent: fear**

Fear refers to a constraint such as threats or blackmail.

**Example**
*A employee takes out an insurance contract because of a threat that he will not be promoted to a higher position in his company in the future if he does not.*

**Defect of consent: fraud**

Fraud is misrepresentation by one of the parties to influence the other party's decision to enter into the contract.

**Example**
*A representative does not state the correct premium amount to get a client to take out a life insurance contract.*

**Defect of consent: error**

Error can involve the type of contract, for instance.

**Example**
*A client signs a disability insurance contract (to cover his salary) when he has in fact given his approval for critical illness insurance.*
Main and Secondary Characteristics

The main characteristics of an insurance contract are good faith and the fact that is a contract of adhesion.

In a contract of adhesion, the essential clauses are drafted by one of the parties without negotiation from the other party.

The contract is formed by the simple acceptance of both parties and is called consensual.

Components of an insurance contract

There are four components that are an integral part of insurance contracts: the insurable interest, the benefit, the premium and the risk.

Insurable interest

The policyholder must have an insurable interest in the life or health of the insured person.

Examples of insurable interest:

- A policyholder with a financial or moral interest;
- A person who supports the policyholder;
- An employee of the policyholder;
- A descendant of the policyholder's spouse;
- The policyholder's spouse;
- The policyholder.

If there is no insurable interest, the insured must provide written consent for the contract to be valid. The insurable interest is determined only when the contract is entered into, not when there is a loss.

Benefit

The benefit is paid by the insurer when the covered risk occurs.

Premium

The policyholder pays the insurer a premium in return for a benefit that the insurer will pay when a covered risk occurs.
Risk

The occurrence of a risk causes financial loss from which the policyholder wishes to be protected.

The risk must be uncertain. It is a possible and future event that does not depend on the will of the parties. A risk cannot be impossible nor can it have already occurred.

Federal Public Plans

Canada Health Act

The *Canada Health Act* is the federal act that governs health insurance. It facilitates access to health services by providing that some of them be offered free of charge.

The Act is based on five principles that the provinces must comply with to receive cash transfers from the federal government. These principles are: public administration, portability, comprehensiveness, accessibility and universality.

Old Age Security Act and Guaranteed Income Supplement

Four plans make up the income security programs: the basic Old Age Security pension, the Guaranteed Income Supplement, the spouse's allowance and the Survivor Allowance.

Old Age Security pension

Canadian citizens who have lived in Canada for at least 10 years after the age of 18 and who are aged 65 or older are eligible to receive the Old Age Security pension.

Guaranteed Income Supplement

To be eligible for the Guaranteed Income Supplement, an individual must have a low annual income and receive the Old Age Security pension.

Spouse's allowance

The spouse's allowance is offered to couples with a low total income and in which one partner receives the Old Age Security pension and the other is aged between 60 and 64.

Survivor Allowance

The Survivor Allowance is for individuals aged between 60 and 64 whose spouse is deceased, who are not the spouse of another person, and who have low income.
**Canada Pension Plan**

The Canada Pension Plan applies in all provinces except Quebec, which decided to set up its own pension plan. The provinces may choose to use their own plan or the Canada Pension Plan. Workers aged 18 and older are required to contribute.

The Canada Pension Plan offers three types of benefits: retirement benefits, disability benefits and survivor benefits.

*Retirement benefits*

Individuals aged 65 or older or between 60 and 64 who no longer work and whose income is lower than the maximum provided for are eligible to receive benefits.

*Disability benefits*

Dependent children of eligible disabled individuals may also receive disability benefits. To be eligible, individuals must be less than 65 years of age, be considered disabled under the *Canada Pension Plan Act*, and have contributed for a sufficient number of years.

*Survivor Allowance*

The Survivor Allowance is paid to the surviving spouse and orphan. Survivors receive benefits if the deceased person paid contributions for 10 years or for one third of the contribution years. A minimum of three years of contributions is required.

**Employment Insurance Act**

Employment insurance provides temporary financial assistance to unemployed individuals who seek employment. It also helps people who care for seriously ill family members, parents with a newborn or recently adopted child, pregnant women, and sick workers.

**Canadian Sources of Law**

**The Canadian Constitution**

The *British North America Act* of 1867 is the foundation of the *Canadian Constitution*. This Act establishes the legislative powers of the federal and provincial governments.

Since the *Constitution Act* of 1982, Canada may amend its constitution without the consent of the British Parliament.

The *Canadian Constitution* has precedence over all other Canadian laws.
Personal Information Protection and Electronic Documents Act

The Personal Information Protection and Electronic Documents Act applies to the collection and use of personal information in the course of business activities in the provinces, including companies under provincial jurisdiction.

Proceeds of Crime (Money Laundering) Act

The Proceeds of Crime (Money Laundering) Act helps Canada in its international fight against crime. It is also intended to fight organized crime through the implementation of policies and measures for detecting and deterring money laundering and the financing of terrorist activities.

Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)

The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) collects, analyses and communicates financial information on money laundering and terrorist activity financing.

A number of persons and organizations must report suspicious financial transactions to FINTRAC. These include financial advisers, insurance of persons firms and independent partnerships, credit unions, banks, and life insurance companies.

Transactions that must be reported

International electronic fund transfers of at least $10,000, large cash transactions of at least $10,000, and transactions that may be related to money laundering and terrorist activity financing and raise suspicion must be reported to FINTRAC.

Reports must be made no more than 30 days after suspicions are raised as to the validity of a transaction with regard to the Proceeds of Crime (Money Laundering) Act.

Money laundering

Money laundering involves three steps. First, the proceeds of criminal activities are introduced into the financial system. Second, these proceeds are transformed into other types of assets. Finally, the proceeds are reintroduced into the economy to conceal their origin.
Example:
Simon opens bank accounts after selling illegal drugs and deposits $9,000 into these accounts (Step 1). Then Simon uses the $9,000 to purchase two paintings (Step 2). Finally, Simon sells off the two paintings for $10,000 and uses the money to purchase investment funds (Step 3).

Social and tax laws

Social laws (governing relations between individuals) have enabled the creation of Canadian public insurance plans such as legislation involving health, pensions, employment insurance, and old age security.

Tax laws have led to the creation of the Income Tax Act.

Canadian Charter of Rights and Freedoms

The Canadian Charter of Rights and Freedoms is called the supreme law of Canada. Legislation passed in Canada may not be incompatible with the provisions of the Charter.

Insurance contracts and the management of provincially chartered insurance companies are under provincial jurisdiction.

Other sources of law

Other sources of law apply to the insurance of persons: case law, doctrine, and customs and usage.

Case law

Case law is an important source of law. It consists of the decisions made by various courts.

Doctrine

Doctrine consists of texts written by legal experts that comment on laws, regulations and case law. It is very useful for interpreting legal texts.

Customs and usage

Customs and usage are the sources least used in law.

Custom is a form of conduct established by usage, habits and practices. It is public in nature and has existed for a number of years.
16. Taxation

Canadian individuals who pay taxes are either residents or non-residents. In all provinces except Quebec, the Government of Canada collects provincial income taxes, which it then returns to the provinces. Although unavoidable, an understanding of the basic principles will allow you to better meet your clients’ needs.

Taxation of Canadian residents

Individuals who remain in Canada a minimum of 183 days during the year and who maintain economic and family ties in the country are deemed Canadian residents for the duration of the year.

They are taxed on their income in its entirety, earned both in Canada and overseas.

Taxation of resident corporations

If administrative control of a corporation is in Canada, the corporation is deemed resident in Canada and must pay taxes on all of its income worldwide, even if the business was incorporated in another country.

A corporation incorporated in Canada is of course considered a Canadian resident.

Taxation of non-residents

Individuals who reside in another country or who have no residential ties with Canada must pay taxes in Canada if they have worked in Canada, carried on a business in Canada, or disposed of property that is taxable in Canada.

The average tax rate

The average tax rate, also called the effective tax rate, is the total tax paid divided by the total taxable income.

Example
Bernard paid $12,500 in taxes last year and had taxable income of $50,000 for the year. His average or effective tax rate is 25% ($12,500 ÷ $50,000).
The marginal tax rate

The marginal tax rate is the tax rate for each additional dollar of taxable income.

Example
Beatrice's taxable income is $50,000. If she contributes $1,000 to her registered retirement savings plan and deducts this amount from her taxable income, how much is the tax deduction?
Answer: $1,000 X 38.4% = $384 tax deduction

Taxable income

Work or employment income

Work or employment income includes wages, remuneration from employment, commissions, professional fees and taxable benefits.

Taxable benefits

The amounts paid by an employer to an employee as part of the latter's employment must be declared each year.

The following benefits must also be declared:

- Trips for personal rather than business purposes which are paid for by the employer;
- Gifts exceeding $500 in value;
- Training paid by the employer which is not required for the job;
- Loans from the employer offered at rates lower than those prescribed by governments;
- Low-rent or rent-free dwellings offered by the employer;
- Vehicle costs paid by the employer;
- Life insurance plans paid for by the employer;
- Employer contributions to medical, hospital and dental care plans (applies to Quebec income tax only).

Business income

Business income refers to the production of goods or delivery of services. It is earned actively, unlike property income, which is earned passively.
**Property income**

Property income is income that is earned passively.

**Example**

*Pascal has a guaranteed deposit of $5,000, a dividend fund of $8,000, and an income property that earns him $12,000 annually in rental income.*

Rental income, interest, dividends and capital gains are included in property income.

**Other types of taxable income**

Pension income and employment insurance are types of taxable income.

Types of pension income include the Old Age Security pension, withdrawals from registered retirement savings plans (RRSPs), benefits paid under the Canada Pension Plan or Quebec Pension Plan, and payments from an RRSP converted into what is called a registered retirement income fund (RRIF).

**Example**

*Ben is 65 years old and has just retired. He receives his Old Age Security pension, his pension from the Quebec Pension Plan, and monthly payments from a registered retirement income fund. All of this income is taxable at Ben's personal tax rate.*

**Taxable income and income tax payable**

There are three steps in determining income tax payable:

1. **Net income**

Net income is calculated by starting with gross income, which is the sum of all income that must be declared (work, investment, pension, retirement, business), and subtracting the allowable deductions relating to this income, such as contributions to a registered retirement savings plan.

**Example**

*Andrew received $45,000 in employment income from a transportation business last year and contributed $1,500 to his registered retirement savings plan. He also collected rental income of $15,000 for his house, which he rents to his brother-in-law. However, he had to repair the emergency staircase, which cost him $5,000. His net income is therefore calculated as follows:*

\[
(\$45,000 - \$1,500) + (\$15,000 - \$5,000) = \$53,500
\]
ii. **Taxable income**

Taxable income is determined by subtracting certain deduction amounts from net income.

**Example**

*Andrew lives in the Bay James area and has claimed a $100 monthly deduction for the area where he lives. He can deduct $1,200 (12 X $100) from his $53,500 net income, which gives him a taxable income of $52,300.*

iii. **Income tax payable**

The income tax payable is derived from the taxable income, to which the following are applied:

First, the appropriate tax rate; and

Second, the relevant tax credits.

\[
\text{Taxable Income} \times \text{Average Tax Rate} = \text{Income Tax owed}
\]

\[
\text{Income Tax owed} - \text{Tax Credits} = \text{Income Tax payable}
\]

**Deductions versus tax credits**

There is a difference between a tax deduction and a tax credit.

**Tax deductions**

Tax deductions reduce net income or taxable income and thereby reduce the income tax payable.

**Tax credits**

Tax credits reduce the income tax payable. Federal and provincial tax credits differ slightly.

Non-refundable tax credits – federal:

- Medical expenses
- Tuition fees
- Disability
- Employment insurance and Quebec Pension Plan or Canadian Pension Plan
- Spouse and dependents
- Age
- Basic personal
- Differences in taxation
Property generates income that receives a different tax treatment based on the type of income.

**Government Plans**

**Registered retirement savings plans (RRSP)**

A registered retirement savings plan is a contract between a financial institution and an individual under which the individual can contribute a maximum annual amount to the plan.

The contributions are tax deductible for the individual and accumulate tax deferred. Amounts withdrawn from the registered retirement savings plan are fully taxable at the individual's personal tax rate.

**Contributions to a registered retirement savings plan**

To calculate the maximum amount that can be invested in a registered retirement savings plan:

- Start with the unused registered retirement savings plan contribution room.
- Add 18% of the earned income for the previous year, up to an established limit.
- Add the pension adjustment reversal
- Subtract the pension adjustment for the registered pension plan or deferred profit sharing plan for the previous year.
- Subtract the past service pension adjustment for the year.

Note that contributions to a registered retirement savings plan for a given year can be made during the calendar year or within 60 days following the end of the calendar year.

**Group registered retirement savings plans**

Employers can create optional group registered retirement savings plans for their employees. Employees contribute to the group registered retirement savings plans and the employers can do so as well if they wish.

The tax rules for individual registered retirement savings plans also apply to group plans.

**Pension adjustment**

The amount invested in a registered pension plan or deferred profit sharing plan is called a pension adjustment, or PA. The pension adjustment reduces the amounts that qualify for a registered retirement savings plan.
Past service pension adjustment

Like the pension adjustment, the past service pension adjustment reduces the amounts that qualify for a registered retirement savings plan. The past service pension adjustment is created when a defined-benefit pension plan member purchases years for past service.

Pension adjustment reversal

The pension adjustment reversal is the excess of accumulated pension adjustments over the value of the pension fund transfer for individuals who sever employment ties with their employer.

Registered retirement income funds (RRIF)

A registered retirement income fund is a tax-free means of transferring the amounts accumulated in a registered retirement savings plan, with an obligation to make a minimum annual withdrawal.

Registered pension plans (RPP)

There are two main types of registered pension plans:

Defined contribution plans

With defined contribution plans, the contributions (by the employer and employee) are defined in advance, but the amount of the annuity on retirement is not (unlike the defined benefit plan).

There is a maximum contribution that can be made by the employer and employee. This limit is the lesser of the following: 18% of annual income or 18% of the money purchase limit for the year.

Defined benefit plans

With defined benefit plans, the employee's contributions are defined in advance along with the amount of the annuity to be received by the employee on retirement.

The employer contributions are not defined in advance, although a minimum contribution is often set.

There is a maximum contribution that can be made by the employer and employee. This limit is the lesser of the following: 18% of annual income or 18% of the money purchase limit for the year.
Deferred profit sharing plans (DPSP)

With deferred profit sharing plans, only the employer contributes to the employee retirement plan.

The contributions can be deducted from the employer's income and are non-taxable for the employee. These contributions generate tax-free income and are taxable when the employee withdraws them, as with registered retirement savings plans (RRSP).

Locked-in retirement accounts (LIRA)

The locked-in retirement account was created by the Supplemental Pension Plans Act and is used to transfer amounts accumulated in a pension fund called a retirement plan.

- The amounts transferred to a locked-in retirement account may come from:
  - a registered pension plan;
  - a deferred profit sharing plan;
  - another locked-in retirement account;
  - an annuity; or
  - a life income fund.

Life income funds (LIF)

The life income fund, which was also created by the Supplemental Pension Plans Act, is used to transfer amounts that have accumulated in:

- a pension plan;
- a locked-in retirement account;
- a deferred profit sharing plan;
- another life income fund; or
- a registered retirement savings plan.

The tax consequences of death on registered plans

Death and Retirement Plans

The general rule is that a taxpayer who dies is deemed to have disposed of all property just before death at its fair market value.

Three exceptions:

i. Amounts paid to the (legal or common law) spouse of the annuitant (deceased person).
ii. Amounts paid to a child who is financially dependent on the annuitant at the time of death and who is totally disabled.
iii. Amounts paid to minor children dependant on the annuitant at the time of death.
Registered retirement savings plan

If amounts from the deceased person's registered retirement savings plan are bequeathed to a surviving (legal or common law) spouse, the spouse can transfer them tax free to a registered retirement savings plan, registered income fund, or eligible annuity.

If the amounts are bequeathed to a dependent child who is totally disabled, either physically or mentally, the child can transfer the amounts tax free to his or her own registered retirement savings plan. This is a total tax-free rollover, the same as with the spouse of the deceased.

If the dependent child is under 18 years of age and is not totally disabled, the after-tax amounts can be used to purchase a fixed-term annuity that does not exceed 18 years less the age of the child.

Registered retirement income fund

The rules that apply to registered retirement savings plans also apply to registered retirement income funds.

Locked-in retirement fund

Locked-in retirement funds are governed by the same tax rules as registered retirement savings plans.

Life income fund

Life income funds are governed by the same tax rules as registered retirement income funds.

Registered pension plan

Following the death of a person with a registered pension plan, if the beneficiary is the legal or common law spouse, the total amount can be transferred tax free to a registered retirement savings plan, a registered retirement income fund, or another registered pension plan.
17. Glossary

**absolute assignment**: the transfer of all of the rights of the original policy owner to another party, including the right to appoint a beneficiary.

**accidental death and dismemberment**: a payment made, in addition to the face value of the policy, if the life insured dies in an accident (also known as double indemnity) that also provides coverage for dismemberment, such as the loss of a limb.

**accident & sickness insurance**: provides all or partial coverage for medical and dental expenses that are not covered by provincial health plans.

**adjusted cost basis (ACB)**: a dollar representation, for tax purposes, of the policy owner’s cost of a policy, e.g. premiums paid.

**administrative services only (ASO)**: a contract with an insurance company that relieves the employer (offering group insurance) from the responsibility of administering its self-insured plan.

**after tax dollars**: money that has already been taxed (income tax).

**allocations**: the annual periodic payments of distributions of income (interest, dividends, or capital gains) within a segregated fund.

**annuitant**: the person who receives an annuity or the proceeds of a segregated fund on death or maturity of the fund contract.

**annuity**: an investment that pays a sum of money annually or at other regular intervals.

**annuity certain**: also known as a term certain annuity. Pays annuitant a guaranteed amount for a defined period,

**any occupation (any occ)**: a definition of disability that means a person is considered disabled if he or she is unable to work at any job.

**automatic premium loan (APL)**: a non-forfeiture benefit which automatically charges unpaid premiums as a loan against the cash surrender value of a policy.

**before tax dollars**: money that has not yet been taxed (income tax).

**beneficiary**: the person who receives all amounts payable when the life insured dies.

**benefit**: income or payment received by the policy owner.

**benefit period**: the length of time an income will be received.

**bond**: represents a debt of a government or corporation to the bondholder.

**business overhead policy**: covers business overhead expenses when the prime revenue earner is unable to produce because of an accident or sickness that causes disability.

**Canada Pension Plan (CPP)**: a federal government retirement and disability pension.

**Canada Savings Bonds (CSB)**: issued by the federal government with regular or compound interest. A minimum interest rate is guaranteed for one or more years, depending on the issue.

**capital gain**: occurs when an investment classified as capital property is sold for more than its purchase price.

**capital loss**: when capital property is worth less than its purchase price and can be used to offset capital gains.

**carry forward**: a feature of RRSPs that allows a person to carry forward any unused contribution indefinitely and apply it to subsequent years.
cash surrender value (CSV): the money in the policy reserve which can be accessed by the policy owner and received in cash. The value of the CSV is premiums plus interest, less costs.

certificate of insurance: the document or booklet which a group plan member receives that outlines the benefits and other relevant details regarding the master contract held by the employer.

claim: the application made on behalf of an insured to recover benefits due as a result of death, disability, or accident.

claimant: the person or legal entity that is claiming the benefit from a life insurance policy.

code of ethics: ethical conduct guidelines that have been established by the Canadian Life and health Insurance Association (CLHIA) and Advocis.

co-insurance factor: percentage of an insurance claim shared between the insurance company (larger percentage) and the insured (smaller percentage).

collateral assignment: when a policy is assigned to a financial institution as security for a loan.

common law: the law which comprises the bulk of law in Canada with the exception of the Province of Quebec. Common law is based on custom and usage dating from ancient unwritten laws in England and which were collected together and established as the Common Law of the Realm. Also known as case law.

common shares: shares which represent ownership in a company and which give the holder voting rights.

compounding: occurs when an person reinvests distributions from an investment (e.g. interest), so that he or she is earning growth on growth (e.g. interest on interest).

conflicting interest: an interest that would likely have an adverse effect on an agent’s judgment, advice, or loyalty to a client or prospective client.

contingent beneficiary: a beneficiary who would receive all or part of the insurance proceeds if the primary beneficiary is not living when the policy matures.

contract: a promise or a set of promises that the law will enforce.

contract of adhesion: the term used for a life insurance contract because the applicant either accepts or declines all of the terms and conditions of coverage that are set out in the contract. There is no opportunity for negotiation.

contributory plan: the group member contributes towards the premium for group insurance.

conversion: a clause that allows convertible term policies and policies with term riders to be converted to permanent life insurance without evidence of insurability.

cost of living adjustment (COLA): an adjustment made to help some incomes keep up with inflation. As an insurance rider benefits will increase according to the amount of increase specified in the rider.

creditor: a person or an institution that is owed money by another.

critical illness insurance (CII): designed to manage the risk associated with contracting certain dreaded diseases.

dearth benefit: the money which is paid to the beneficiary upon death of the life insured.

dearth benefit guarantee: the minimum guaranteed amount (usually 75%) on the deposits (or reset amount) if the holder of a seg fund should die before the maturity date of his or her contract.
debenture: a bond which is supported by the general credit worthiness of the issuing corporation.

debtor: a person who owes money.

decreasing term insurance: (infrequently used) term insurance which provides a level premium over a long term, a decrease in the face amount each year, and a death benefit paid to the beneficiary for the face amount in force at the time of death of the life insured during the term specified in the policy.

deductible: an amount the insured pays before payment is received from the insurer.

deemed disposition: occurs when the Canada Revenue Agency considers property to be sold at market price, even if it was not actually sold.

defered annuity: an annuity that begins at a future date. The annuity can be purchased with either a single premium or a series of premiums.

defered sales charge: the investor pays a sales charge when all or part of the original investment is redeemed. The sales charge declines over an agreed upon number of years until, at the end, the charge is eliminated.

defined benefit plan: a private pension plan where the employee knows exactly how much he or she is going to pay for the pension and how much he or she will receive when retired.

defined contribution plan: pools contributions of the employer and the employee to provide the pension. Also called a money purchase plan.

disability: as defined in a policy (for example, it may cover a physical impairment but not a mental disability); however, the disability must result from an accident or sickness that occurred while the policy was in force, and the disability must require medical attention.

disability buy-out insurance: can only be used for businesses that have buy-sell agreements in place. It allows partners, owners, or shareholders of a business to purchase the share in the business held by another partner, owner, or shareholder who becomes disabled.

disability income insurance: provides a monthly income to those unable to work because of an accident, sickness, or disability.

distributions: the periodic payments of interest or dividends made by mutual funds or segregated funds.-also allocation

dividends (corporate): a share of profits that have been earned by the corporation and distributed to shareholders on a pro-rata basis.

earned income (for disability insurance): includes salary, wages, regularly received bonuses, and commissions.

earned income (for RRSP and tax purposes): earned income for tax purposes includes income from all sources, whereas earned income for RRSP purposes does not include investment and pension income.

effective date: the date that the policy takes effect and coverage starts.

elimination period: the time between the occurrence of the disability and when benefits begin. The waiting period during which benefits are not paid.

ersors and omissions (E&O) insurance: professional liability coverage carried by insurance agents and insurers against lawsuits claiming mistakes in professional judgment, and/or failure to properly execute the steps of putting a policy into effect.

estate: a term commonly used on a person’s death to refer to all of his or her assets.
ethical conduct: the measure of a life insurance agent’s business character and his or her adherence to the codes of ethics established by CLHIA and Advocis.

evidence of insurability: information which demonstrates that a life insured can qualify for coverage.

exclusion rider: a rider that excludes some coverage.

exclusions: benefits denied under certain circumstances.

extended term insurance (ETI): an option which allows a policy owner who stops paying premiums to keep coverage in force by using the cash surrender value as a single premium to buy term insurance.

face amount: the amount of the insurance payable.

fair market value: the value of an item today. It is based on what similar items are being sold, or bid, for in the marketplace.

family deductible: a maximum amount the insured pays for all family members covered under the group plan. Each person in the family is subject to a single deductible until the family maximum deductible is reached.

forgery: something written or prepared in writing to deceive, such as a false signature. Forgery is a criminal offence.

fraud: a fraudulent misrepresentation intended to cheat or deceive; within the insurance industry it is possible for the insured to defraud the insurance company and the agent, or the agent to defraud either the customer or the insurance company. Fraud is a criminal offence. A policy will be terminated if fraud has been committed.

front-end load: a sales charge that is applied at the beginning of a fund contract.

fully-insured plan: a group plan where the policy owner pays a premium and the insurer pays all claims. Under this plan, it is possible for claims to exceed premiums.

future purchase option (future income option): allows the policy owner to increase the amount of monthly income protection with no evidence of insurability.

grace period: the 30 or 31-day period during which the policy remains in full force before a policy is lapsed for non-payment of a premium.

group insurance: pools the risk of individual members of the group to provide insurance without requiring evidence of insurability.

group retirement savings plan (GRSP): provides benefits similar to those offered by individual RRSPs except the employer administers them on a group basis. Employees contribute by wage deduction, matched in whole or part by employer.

Guaranteed Income Supplement (GIS): monthly benefits paid to residents of Canada who receive the OAS and have little other income.

guaranteed insurability: a benefit that protects the life insured from becoming uninsurable by giving the policy owner the right to buy more life insurance at certain times.

Guaranteed Investment Certificates (GICs): an interest-paying investment in which principal and interest are guaranteed.

health insurance: sold through accident and sickness policies, it reimburses the insured for out-of-pocket expenses.

holding out: how an agent presents himself or herself to the general public. A license to sell life insurance must be obtained before a person can be identified or held out as a licensed life insurance agent.
**home buyer’s plan:** allows an RRSP plan holder to withdraw up to $25,000 as of 2009 ($20,000 previously) from his or her RRSP for the first-time purchase of a home or for buying a home under certain conditions.

**immediate annuity:** purchased with a single premium. Income begins at the end of the first annuity period after it is purchased (e.g. if the annuity period is one year, the first payment is received one year after the annuity has been purchased.

**income splitting:** a term used to describe strategies used to save taxes by diverting income from a high tax-bracket family member to a family member in a lower tax bracket.

**incontestable clause:** clause that states that a life insurance contract is incontestable by the insurer when it has been in effect continually for two years after the issue or reinstatement date.

**increasing term insurance:** term insurance which covers a life that is increasing in economic value, such as an essential employee whose salary increases annually.

**Individual Variable Insurance Contract (IVIC):**
the contract that buys into a segregated fund.

**insurable interest:** when the death of the insured would be detrimental or cause harm to the person taking out the insurance.

**insured:** the person who is the owner (policy owner) of the policy and pays its premium.

**insurer:** the party to an insurance arrangement who undertakes to indemnify for losses. Also called the insurance company.

**interest:** the charge for the privilege of borrowing money.

**intestate:** when a person dies without leaving a will.

**investment returns:** the returns (growth in value) investors receive on their investments.

**irrevocable beneficiary:** the policy holder cannot change the beneficiary unless the beneficiary agrees in writing to the change.

**joint and last survivor annuity:** provides a guaranteed income during the course of two people’s lives.

**joint first/last to die:** a contract in which more than one life is insured and settlement is made to either the survivor (first to die) or the beneficiary (last to die).

**key person life/disability insurance:** insurance used to cover a person who is a key employee. There are three parties to this contract: the policy owner (business), the life insured (employee), and the insurer.

**know your client:** part of the Code of Ethics for life insurance agents which states that an insurance agent must make every effort to understand his or her client’s needs and financial situation.

**law of large numbers:** a theorem which states that, as an experiment is repeated over and over, the observed probability approaches the actual (or true) probability.

**legal capacity:** a person is legally able to enter into a life insurance contract.

**level term insurance:** term insurance which specifies in the policy exactly how much the insurance will cost, how much it will pay out, who will receive the death benefit, and when the insurance expires.

**liability risk:** the risk of being held financially responsible for causing injury to another person or causing damage to another person’s property.

**life annuity:** makes income payments for the lifetime of the annuitant.
**Life Income Fund (LIF):** retirement fund into which the accumulated savings in a Locked-in RRSP, LIRA, another LIF, pension funds, may be transferred and then paid out to the fund owner as retirement income.

**Life Insurance:** insurance which provides financial protection against financial loss resulting from death.

**Life Insured:** the person whose life is insured by the life insurance contract.

**Life License Qualification Program (LLQP):** an entry-level proficiency standard for individuals that want to become life insurance agents in all provinces except Quebec.

**Life Retirement Income Funds (LRIF):** a variation on the life income fund (LIF) in which there is no requirement to purchase an annuity by age 80.

**Limited Payment Whole Life:** another form of whole life insurance. Premiums on these policies are limited and only payable for a certain period or to a certain age.

**Liquidity:** the ease with which investments can be converted to cash or near cash.

**Loads:** sales charges for a mutual or segregated fund.

**Locked-in Retirement Account (LIRA):** a form of Locked-in RRSP into which pension benefits may be transferred from an employer's plan when the employee leaves the company prior to the age of retirement.

**Locked-in Retirement Income Fund (LRIF):** a variation on the Life Income Fund in which there is no requirement to purchase an annuity by age 80.

**Long-term Care Insurance:** payable when the health condition of the life insured requires long-term care, such as in a nursing home.

**Long-term Disability Policy:** has a benefit period of five years or longer. Benefits begin after short-term disability or government benefits end.

**Lump Sum Payment:** a single payment received for a death claim or reimbursements for medical expenses incurred while travelling or, depending on the type of policy, for treatments or prescriptions.

**Management Expense:** fees that cover the cost of running a segregated fund.

**Marginal Tax Rate:** the highest rate at which an individual is taxed.

**Master Contract:** the group insurance policy which is given to the policy owner, usually an employer.

**Maturity Guarantee:** provides for the guaranteed return of at least 75% of the initial deposit to a segregated fund 10 years after the date the contract is signed by the investor.

**Meeting of the Minds:** when the parties have agreed to all the details of a contract.

**Minor:** an individual who has not reached the age of majority as defined in the province where he or she resides.

**Misrepresentation:** when one of the parties to a contract has been induced or persuaded to enter into the contract through the misrepresentation (or false representation) of the other party.

**Money Laundering:** the process whereby money that has been gained illegally is moved into the economy.

**Morbidity Rates:** used to estimate the number of people expected to become disabled at a given age, based on 1,000 people of the same age.

**Mortality Rates:** the number of people expected to die at a given age, based on 1,000 people of the same age.

**Mutual Company:** a company owned by policy holders.
**mutual funds**: pools of money managed by professional fund managers, funded by investors with similar investment objectives. The fund’s portfolio may consist of a variety of investments.

**National do not call list**: regulation pertaining to solicitation and telemarketing using the telephone.

**needs analysis**: the process of analyzing the amount of insurance required to meet a client’s requirements at a particular point in time.

**net cost of pure insurance (NCPI)**: the life insurance cost within the policy.

**no-load fund**: a fund that charges no sales fee but usually compensates by charging a higher management expense fee.

**nominal rate of return**: the “named” rate of return for an investment (i.e. a GIC that pays 4% interest; 4% is the nominal rate of return).

**non-contributory plan**: the group policy owner, often the employer, pays the full premium for the group insurance.

**non-exempt policy**: the policy owner must report the income that is accruing in the policy yearly.

**non-forfeiture option**: a benefit or value that allows coverage to continue even if premiums are not paid. There are three non-forfeiture values: automatic premium loan, extended term insurance, reduced paid-up insurance.

**occupational classification**: the five categories into which occupations have been classified based on the likelihood of a claim being made. The classification is based on the hazard inherent in the job and the likely duration of the disability that will result from work in that occupation.

**Old Age Security (OAS)**: a monthly pension payable to all Canadians or legal residents age 65 and over who apply for the benefit and meet residence requirements.

**overhead expenses**: expenses incurred in running a business.

**overinsurance**: paying more to a disabled person than the person received as earned income.

**own occupation (own occ)**: a definition of disability that applies to a person who is unable to perform the essential duties of his or her own regular or previous occupation.

**paid-up addition**: where dividends are used to buy additional paid-up insurance.

**paid-up additions rider**: adds paid-up permanent life insurance as a policy and it requires additional premium payments from the policy owner.

**partial disability**: definition which covers a percentage of the total disability benefit, as defined in the policy. Unlike residual disability, it is based on the inability to perform tasks, not on the loss of income.

**participating policy (par policy)**: a whole life policy which pays dividends.

**partner**: one of two or more individuals in a business organization (referred to a partnership) that has a financial interest in, or who manages and operates the business.

**past service pension adjustment**: the adjustment an employer makes to an employee’s pension plan for the years the employee worked for the employer before the pension plan was implemented.

**pensionable earnings**: the amount of income on which the pension contribution is based.
**pension adjustment:** the value of benefits accruing in a company-sponsored RPP or a DPS. Pension adjustment for any current year must be deducted when calculating the allowable RRSP contribution for the subsequent year.

**permanent insurance:** insurance which insures for life.

**policy dividends (life insurance):** an overpayment of premiums by the participating policy owner returned to the policy owner in annual dividend form. They are not guaranteed and there are a number of ways the dividends can be received.

**policy illustrations:** point-of-sale tools used to illustrate hypothetical policy dividends and other benefits derived from life insurance products that are not guaranteed.

**policy loan:** loans made against the cash surrender value of a policy. Most insurers limit loans to 90% of the CSV.

**policy owner:** the owner of a policy, the policyholder.

**power of attorney:** the appointment of a person to look after financial affairs of someone who becomes incapacitated due to sickness, accident, or other mishaps.

**precedent:** a past or present decision of a judge of a court that serves as the guiding principle in similar cases in other courts.

**pre-existing condition:** a disability or illness which exists at the time of application.

**preferred shares:** a type of share that entitles the owner to a dividend ahead of any dividends paid to common shareholders. Preferred shareholders typically do not have voting rights.

**premium:** legally, the consideration for the contract; in other words, the payment required to bring the policy into force and to keep it in force.

**premium offset:** when dividends from a whole life policy are used to reduce the cost of premiums.

**premium rebating:** prohibited by provincial legislation and association by-laws. Premium rebating usually occurs when an agent offers to pay all or part of the premium required by the policy, it may also involve a gift, promotion, or inducement.

**prescribed annuity:** annuity payments are a blend of capital and interest. The capital is spread evenly over the expected payment period and the balance of each payment is the interest. The interest portion is subject to tax, while the capital portion is tax-free.

**presumptive disability:** definition which covers the loss of use of limbs, sight, hearing, or speech. Full benefits are payable until the end of the benefit period or for life, regardless of whether or not the person can return to work.

**probate fee:** the fee that is levied by the provincial jurisdiction; it is a percentage of the value of the estate.

**proceeds of disposition:** money received following a disposition.

**public company:** refers to a company that is permitted to offer its registered securities (stock, bonds, etc.) for sale to the general public through a stock exchange.

**pure premium:** the premium rate that actuaries calculate solely on two factors: mortality/morbidity rate and projected earnings.

**Quebec Pension Plan (QPP):** the Quebec equivalent of the Canada Pension Plan.

**rated contract:** a contract with higher premiums offered to applicants identified as special risk or substandard risk.

**rated premiums:** higher-priced premiums.

**ratemaking:** the calculation of premium rates by actuaries which factors in mortality/morbidity rates, interest earnings, and the operating expenses of the company.
real rate of return: the nominal, or “named” rate of return on an investment minus the current rate of inflation.

recurring disability: if a disability recurs or a new disability begins within a period of time set out in the policy’s recurrence clause, it is treated as a continuation of the original claim and not subject to a new elimination period, but the benefit period is deemed to begin at the start of the original claim, not the date of the recurrence.

reduced paid-up insurance (PUI): an option when a policy owner stops paying premiums to convert the cash surrender value to a reduced face amount of the same policy type.

registered education savings plan (RESP): a savings program developed by the federal government to encourage parents to save for the post-secondary education of their children.

registered disability savings plan (RDSP): a plan intended to accumulate savings for a disabled person

registered pension plans (RPP): private pension registered with CRA, established by employers for the benefit of their employees.

registered plan: a plan that has been registered with the Minister of Customs and Revenue as required by the Income Tax Act.

registered retirement income fund (RRIF): a fund registered with CRA to receive retirement income. It is an account to which accumulated RRSPs can be transferred without incurred tax at the time of transfer.

registered retirement savings plan (RRSP): a registered savings plan which is a tax shelter to assist individuals in saving for their retirement years.

regular occupation: a definition of disabled that applies to a person who is unable to perform the essential duties of his or her regular occupation.

reimbursement plan: the insured pays the cost of the medical service or drugs and is reimbursed by the insurer.

reinstatement clause: a clause in the policy designed to assist when a life insurance contract lapses due to premium non-payment.

renewable and convertible (R&C): a feature of term policies which allows the insured to renew the policy prior to the expiry date and the right to convert the policy to a whole life policy (a type of permanent life insurance), for the same or a decreased face amount, without evidence of insurability.

replacement: a term used to describe the act of surrendering an insurance policy or part of the coverage of an insurance policy in order to buy another policy.

reset feature: when investors decide to lock in the value of their segregated funds, thereby resetting the maturity guarantee and maturity date of the contract.

residual disability: the benefit paid proportionate to pre-disability earnings. The loss must be between 20-80% of pre-disability earnings to qualify for a residual benefit.

revocable beneficiary: the policy owner may change the beneficiary named in an insurance contract at any time, in writing.

riders: policy extras. Premiums are higher based on the riders that are attached to the policy.

right of rescission: the right to cancel the policy within ten days of acknowledgment of receipt of the policy. Also called free look provision.
risk: the probability of suffering harm or loss in the future. Another definition is the price volatility of one type of security compared to the price volatility of another.

risk averse: relates to the behaviour of investors and their reluctance to make an investment with an uncertain payoff, compared to an investment with a more certain expected payoff.

risk management: the process of planning for risk.

risk retention: when a person accepts or retains all or part of a given risk.

risk severity: the dollar cost of a loss.

risk transfer: shifting some or all of the cost of a potential loss to a third party.

rule of 72: illustrates how long it takes for an investment portfolio to double in size when its income is reinvested.

segregated funds (seg fund): an investment fund held by an insurance company called an Individual Variable Insurance Contract (IVIC), in which the funds are separate from the other assets of the insurance company.

self-insured plan: the group policy owner pays all claims.

settlement: the amount paid to the beneficiary when the life insured dies.

shareholder: an individual or company (including a corporation) that legally owns on or more shares in a company.

short-term disability policy: has a benefit period of two years or less.

sole proprietor: one person who owns and operates an unincorporated business, and who pays personal income tax on profits from the business.

special risk: a rating assigned to some life applicants who are at high risk for some reason usually due to health, habit, or occupation. Also known as the fifth dividend option.

speculative risk: a risk where someone knowingly gambles on a risk, such as the stock market.

stock company: a company owned by shareholders.

stock market indices: statistical tools used to measure the state of the market or the economy.

straight life: the most common form of whole life policies. Premiums are paid over the entire lifetime of the life insured. Also called whole life.

straight life annuity: pays a guaranteed income for life.

subrogation: a legal process that allows an insurance company to assume the policyholder’s right to collect damages from a third party.

substandard risk: a rating assigned to some life applicants who are at high risk for some reason.

suicide exclusion clause: suicide is excluded as a cause of death for which the death benefit is paid if it occurs up to two years after the policy is issued.

summary fact sheet: a document which outlines a summary of performance, the investment policies, and the three largest holdings of a segregated fund.

supplementary benefits: policy extras.

tables of non-forfeiture: the tables the policy owner can use to determine the value of the non-forfeiture options in the policy.

tax credits: a direct reduction in tax.

tax deductions: expenses, payments, and contributions that are allowed to be deducted from taxable income.
**tax deferral:** tax is paid at a later date.

**Tax-free Savings Account:** An account to which contributions are not tax deductible but withdrawals are tax-free

**taxable income:** income received during the year that is subject to Canadian income taxes.

**temporary insurance agreement (TIA):** a temporary but binding contract between the insurance company and a proposed life insured to provide coverage during the underwriting process. Also called conditional insurance agreement.

**term additions:** uses the whole dividend of a whole life policy to buy a non-renewable one-year term addition that will be paid if the life insured dies during that year.

**term insurance:** life insurance for a specific period of time.

**terminal illness benefit: living benefit** payable when the death of the life insured will occur within six months as declared in a doctor’s certificate.

**term-to-100 insurance:** a hybrid of term insurance and permanent insurance which provides a term-type policy to age 100.

**third party contract:** a contract in which the insured insures the life of another person (the life insured).

**tied selling:** when a financial institution requires a client to transact other business with the institution as a condition of doing business.

**time horizon:** the length of time available for money to be invested before it is needed.

**time value of money:** the sum of money received today is worth more than if the same amount of money is received in the future.

**tolerance for risk:** the level of risk a person is prepared to take in the purchase securities and insurance.

**tort law:** designed to compensate a person who has been harmed for any damage caused by wrongful civil behaviour.

**total disability:** is defined in the insurance policy by the work the insured may be able to resume.

**treasury bills (T-bills):** short-term investments issued by the federal government.

**twisting:** when an agent induces a policyholder to surrender or lapse a policy with one insurer and replace it with another insurer, to the detriment of the policyholder.

**unbundling:** the listing separately of the cost of insurance, the guaranteed interest rate, and the expense charges of the insurer in a universal life policy.

**underwriter:** insurance official who assesses risks.

**underwriting:** the process of assessing and classifying the potential degree of risk that a proposed insured represents to an insurance company.

**universal life insurance:** an interest rate-sensitive policy that is a unique combination of insurance and investment.

**unused contribution room:** the dollar amount that a taxpayer is allowed to contribute to an RRSP.

**waiting period:** the period from the time a claim is made until benefits begin (provided in the policy).

**waiver of premium:** a rider to a policy which ensures that the premiums on the policy are paid if the life insured becomes disabled.

**waiver of premium for payor:** pays the premiums on a policy if the policy owner, in a third party contract, is disabled.
whole life insurance: permanent insurance available as straight life or limited payment life. These policies are in force for the lifetime of the insured and are guaranteed policies. will: a legal document expressing the desires of the author with regard to the disposition of property after the author's death. yield: return on investment. yield to maturity: the return an investor can expect by holding an investment to maturity.