

CI BUSINESS SOLUTIONS

GROUPING OF INDIVIDUAL CRITICAL ILLNESS INSURANCE CONTRACTS



SALES SUPPORT DOCUMENT

*The advantages of group insurance,
though undeniable, are not the only
attractive features for employees.*

*Here's a new type of coverage with a
significant distinction to establish
employee loyalty and facilitate
recruiting.*



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1.0 GENERAL CONCEPT

Business owners often rely on a group of managers or employees who work in strategic or specialized positions. Where there is a shortage of manpower and payroll reaches a critical threshold, business owners seek innovative solutions to hire qualified staff and minimize the turnover rate. As an advisor, you can help them by proposing grouping Transition individual critical illness insurance contracts. This guide describes the advantages of this program and how to set it up.

OVERVIEW OF PROGRAM IMPLEMENTATION

Employee category	<ul style="list-style-type: none">• The group of employees must have a common element (e.g. all members of the management team).• The group must be made up of at least 2 insurable employees• The same coverage must be offered to all members of the group
Benefits	<ul style="list-style-type: none">• Type and amount of the critical illness coverage
Documents	<ul style="list-style-type: none">• Board of directors' resolution or document that establishes employer's commitment
Applications	<ul style="list-style-type: none">• Transition Simplified Issue is a great choice• All applications submitted for the regular Transition product will be subject to the entire underwriting process

2.0 THE IDEAL COMPLEMENT

GROUPING OF INDIVIDUAL TRANSITION CRITICAL ILLNESS INSURANCE CONTRACTS COMPARED TO A GROUP INSURANCE PLAN

You may already be familiar with the concept of shared ownership critical illness insurance. Why not complete your service offer by proposing that the employer integrate a grouping of Transition individual critical illness insurance contracts to cover key employees?

First, by implementing a shared ownership insurance strategy, a company covers the financial risks resulting from the temporary loss of one of its shareholders and/or key employees and can benefit from a tax advantage if they use the Flexible Return of Premiums when the contract is surrendered. Second, not only does a business protect itself against financial risks resulting from the temporary loss of one of its key employees, but it can also offer coverage to these employees to obtain the care they need in case of critical illness and focus on their recovery.

You can now propose that your existing business clients consider adding Transition critical illness insurance to their financial planning with the potential to expand the approach to other categories of employees.

3.0 TARGET CLIENTELE

Stock companies, partnerships or single owners with a minimum of two employees in a same category (management personnel, labourers, office workers) with or without a group insurance plan.

4.0 OBJECTIVES

1. Offer critical illness insurance coverage to a category of employees as appreciation and at a reasonable cost for the employer.
2. Reduce the financial burden caused by unexpected expenses resulting from a critical illness while allowing the employee and his family to concentrate on his recovery.

5.0 SALES TOOLS

Though all Transition coverages can be used to implement the program, Transition Simplified Issue seems ideal because it allows for:

- A quick and easy selection process by answering 9 questions
- Rapid identification of eligible insureds

By opting for Transition Simplified Issue, your critical illness sales approach will be far easier. Your client will be covered for the four illnesses or conditions that account for more than 90% of critical illness claims: cancer, stroke, heart attack or coronary bypass surgery.

Here are other advantages of Transition Simplified Issue:

- ✓ More than 85% of the population of qualifying age may be accepted
- ✓ No extra premium
- ✓ No medical exam
- ✓ Guaranteed premiums

If you're uncertain about Transition Simplified Issue's 9 questions, please refer to the F13-746A sales support document, which will supply more information about the questionnaire.

6.0 APPROACH

This approach involves identifying one or more categories of employees in a company to whom the employer wants to offer critical illness coverage as appreciation. The employer is the policyowner and pays the insurance premiums for the employees eligible for the coverage.

Here are the main advantages of this approach for the employer and the employee:

6.1 FOR THE EMPLOYER:

- Premiums are fixed, guaranteed and predictable, unlike a group insurance plan where premiums are adjusted every year.
- Offer coverage that isn't normally included in group insurance plans.
- Deduct premiums for the coverage as an expense incurred to earn corporate income.
- The plan can be implemented simply through a document that establishes the employer's commitment to provide a certain group of employees with critical illness coverage. For example, a resolution by the company's board of directors, a sample of which you will find in section 11 of this document.

6.2 FOR THE EMPLOYEE:

- The employer pays the premium on behalf of the employee, which is not a taxable benefit for said employee, except in Quebec. For Quebec residents, premiums paid by the employer are a taxable benefit for provincial income tax, and may not be deducted as medical expenses.
- The face amount, if any, is paid tax-free.
- Unlike a group insurance plan, which doesn't provide for a transfer privilege in the event of termination of employment, an employee who wants to take charge of the premium payment without modifying the premium and insurance benefits can keep the contract in force.

7.0 IMPLEMENTATION CONDITIONS

Certain conditions must be met to implement grouping of Transition individual critical illness insurance contract and have it recognized as a group accident and health insurance plan for tax purposes. To fully benefit from the resulting tax advantages, the document that establishes the employer's commitment (a model Board of Directors Agreement is available in section 11) must be appropriately documented and specify the following items:

- The plan objective (employer's commitment to provide critical illness insurance to one category of employees)
- The category of employees to whom the protection is offered must contain a minimum of two insurable employees (essential condition for plan eligibility under paragraph 6(1)(a) of the Canada *Income Tax Act*)
- The description of the categories of employees to be covered by the plan, eligibility conditions, type of coverage and face amount. For example:
 - Category – Senior managers
 - Eligibility conditions – Be employed for a minimum of three months and be part of the category of employees.
 - Face amount – A fixed amount of coverage, such as \$50,000 or one time the annual salary, excluding bonuses and other forms of compensation.
- The employer pays the premium for the individual critical illness insurance policies established.
- The employee designates the beneficiary of the coverage and the employer must respect his choice.

- The provisions for transferring the coverage upon termination of employment must be specified. Said transfer provisions are part of the model agreement available in section 11. Elements to consider concerning the taxable impact of such a transfer are described in section 9.8 of this guide.

8.0 ADVANTAGES

GROUPING OF TRANSITION INDIVIDUAL CRITICAL ILLNESS INSURANCE CONTRACTS COMPARED TO A GROUP INSURANCE PLAN

- Even though the premium is paid by the employer, it's not a taxable benefit for the employee (except in Quebec).
- The employer can budget its costs because the premiums are guaranteed for the duration of the contract compared to an annually adjusted premium in a group insurance contract (due to higher than expected incidences requiring an increase in insurance premiums).
- The insurance is transferable upon termination of employment without changing the premium and without having a new contract issued.

9.0 TAX POINTS

GROUPING OF INDIVIDUAL CRITICAL ILLNESS INSURANCE CONTRACTS

9.1 OWNERSHIP OF GROUPED INDIVIDUAL CONTRACTS

Grouped individual contracts can be held by the company or by the insured employees. The tax treatment for the company or employee will be identical in either situation.

9.2 CRITICAL ILLNESS COVERAGE CONSIDERED AS ACCIDENT AND HEALTH INSURANCE

According to various interpretation bulletins and industry roundtables, it is understood that a single critical illness insurance coverage will be considered as accident and health insurance. The addition of refund of premium riders, including a refund at death, on the critical illness insurance contract could call into question the contract's primary character, as it could be considered a life insurance contract¹. For this reason, it's preferable that refund of premium riders not be added.

¹ The CRA generally agrees that critical illness insurance contracts that don't provide refund of premium benefits are accident and health insurance contracts. The CRA also declares that when a critical illness insurance policy contains a refund of premiums benefit, it doesn't necessarily mean that it cannot be considered an accident and health insurance contract. According to the industry, the existence of ancillary benefits such as the refund of premiums shouldn't modify the policy's character. In Quebec, critical illness insurance with refund of premium riders will be considered health or accident insurance since, under the civil code, a contract is classified according to its primary benefit rather than its ancillary benefits.

In a normal non arm's length employment relationship, an employer would not agree to grant this type of advantage (refund of premium benefits) to an employee unless he is one of the company's owners. In this case, the addition of refund of premium riders could create an undesirable situation and call into question the intention of the contract consolidation program. It's also important to consider the question of whether the premium for the refund of premiums riders is an expense incurred to earn business income, making it deductible for the employer (paragraph 18(1)(a) of the Canada *Income Tax Act*).

For tax reasons, we recommend that refund of premium riders not be added because the CRA still hasn't stated its position as to whether or not critical illness coverage can lose its status as accident and health insurance. However, if these riders are added to coverage, we recommend that the employer not deduct the premium because if it does, the benefit paid under these riders will generally represent a refund of expenses and will be included in the income.

9.3 MINIMUM NUMBER OF PARTICIPANTS

At least two insurable participants are required to group individual critical illness insurance contracts. If for any reason the group ends up with a single person, a taxable advantage may be attributed to him.

9.4 CATEGORY OF EMPLOYEE²

Different benefits can be offered to different categories of employees, with each category making up a distinct "group," as long as the employees in a same category are eligible for each plan considered as a distinct plan. The premiums and other expenses shared between the employer and the employees must be distributed in the same proportion for all participants. Employees that make up a category should have a common element and all employees that have this common element should be included in the category.

9.5 PARTICIPANTS WHOSE CRITICAL ILLNESS INSURANCE APPLICATIONS ARE REFUSED

Out of fairness and to offer the same benefit to other employees in the same category, the employer can make lump-sum contributions to the individual or group RRSP of employees whose critical illness insurance application is refused (subject to the employee having unused contribution room). This benefit, however, will be taxable for the employee. For the employee, the benefit is taxable as part of salary received, but deductible as part of his yearly contribution.

²Interpretation bulletin no 9233485 – January 13, 1993

9.6 EMPLOYEE SHAREHOLDERS

Employers, specifically owners who actively manage their businesses, must know the CRA administrative rules concerning the evaluation of benefits granted to shareholders when they deduct personal expenses through their companies. The CRA could establish that a benefit is granted to the shareholder according to paragraph 15(1) of the Canada *Income Tax Act* if a benefit is granted to him as an employee, but this benefit is not offered to a non-shareholder employee who belongs to the same category of employee. The CRA could also refute the deduction to the business in a similar situation. The shareholder should be included in a category that contains several employees who have the same or similar job conditions.

Therefore, it's important that the document that establishes the employer's commitment be well-documented to demonstrate the intention to offer accident and health coverage, thus justifying the deduction for the company and that no benefit be granted to the shareholder. It's extremely risky to bypass this step, because in the event of an audit, the program's status as a group accident and health insurance plan could be refused and the employer could be denied the related tax benefits.

Shareholders and their families cannot make up a category of employees on their own.

The partners in a general partnership cannot act as employees of their own company. Therefore, they are not eligible for group accident and health insurance plans.

9.7 COMPANIES

In partnerships, partners are supposed to operate a company as co-owners and not employees of the company. Consequently, the partners are not eligible for group accident and health insurance plans. On the other hand, the employees of a partnership can be insured under such a plan.

9.8 TRANSFER OF AN INDIVIDUAL CONTRACT THAT IS PART OF A GROUPING TO AN EMPLOYEE UPON TERMINATION OF EMPLOYMENT

When an employee leaves the company, he may want to have the rights under the individual insurance contract held by the company as part of the program transferred to him. The transfer of ownership rights of an accident or health insurance contract has no tax impact for the company that owns the contract. However, in accordance with paragraph 6(1)a) of the *Income Tax Act*, the transfer could grant a benefit to the employee. The value of this benefit will be tied to the value received as a contract.

According to the CRA, the following elements must be considered in order to determine the fair market value (FMV) of an insurance contract:

- The policy's surrender value (SV)
- The policy loan amount that could be obtained
- The face value
- The insured's state of health and life expectancy
- Conversion privileges
- Other policy conditions, e.g. temporary riders and benefit-splitting clauses
- The replacement cost

10.0 NOTICE

We strongly recommend that clients consult a tax specialist or legal advisor to obtain independent professional advice about the potential tax consequences of grouping critical illness individual insurance contracts.

11.0 MODEL BOARD OF DIRECTORS AGREEMENT

AGREEMENT AUTHORIZING THE ESTABLISHMENT OF A GROUP ACCIDENT AND HEALTH INSURANCE PLAN.

Grouping of individual critical illness insurance contracts

WHEREAS it is desirable to offer critical illness insurance coverage to certain employees of _____ (hereafter called the "company") providing for the payment of benefits following the diagnosis of one of the illnesses or conditions covered and the prescribed survival period for this type of contract;

WHEREAS the coverage offered by the company will be established as part of a group accident and health insurance plan (hereafter called the "plan");

WHEREAS the plan will be offered to the following employees:

Name of category 1

Eligibility conditions

Amount of coverage

_____ (names of category 1 employees)

Name of category 2

Eligibility conditions

Amount of coverage

_____ (names of category 2 employees)

It is unanimously agreed:

1. That individual critical illness policies are purchased from (Industrial Alliance Insurance and Financial Services Inc. or Industrial Alliance Pacific, Insurance and Financial Services Inc.) for each eligible employee. Benefits will be paid in accordance with the policies.
2. That the company be the owner of the individual critical illness insurance contracts included in the plan and pay the premiums for them.
3. That all critical illness benefits payable under these contracts be paid by (Industrial Alliance Insurance and Financial Services Inc. or Industrial Alliance Pacific, Insurance and Financial Services Inc.) directly to the beneficiaries designated in the contracts.
4. That in the event of the termination of employment of an employee covered by the plan or in the event of termination of the plan, that the company cede to the employee any contract in accordance with the plan that covers the employee.

Made on _____ at _____

Signature, name and title

Signature, name and title