Domestic vs. Foreign Issued Exempt Life Insurance

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Prepared by

N. Gregory McNally, LL.B., M.B.A., J.D., LL.M (Int'l Tax), TEP
OffshoreConsulting.ca

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Peter W.B. Everett, LL.B, CLU, TEP
PPI Financial Group (Toronto)

-and-

Charles C. Gagnon, BCL, LL.B, TEP

Definition of Insurance

For the purposes of this paper we will define "Life Insurance" as exempt universal life insurance that is compliant with Canadian regulations. This paper is not intended to review details of corporate owned policies.

Regulatory Issues

The sale of insurance in Canada is regulated in the first instance by the provinces with some dual regulation and oversight by the federal government. Generally speaking the sale of insurance by non-licensed issuers or agents in Canada is prohibited. Section 573(1) of the *Insurance Companies Act* (Canada) states:

573(1) A body corporate incorporated elsewhere than in Canada, including an association and an exchange, shall not in Canada insure a risk unless the Superintendent has, by order, approved the insurance in Canada of risks by the body corporate.

In Ontario, ss. 40(2) of the *Insurance Act,* R.S.O. 1990, c.I.8, prohibits anyone from carrying on insurance business in Ontario without a license. Subsection 39(3) defines "carrying on business" as:

39(3) An insurer undertaking insurance in Ontario or that in Ontario sets up or causes to be set up a sign containing the name of an insurer, or that in Ontario maintains or operates, either in its own name or in the name of its agent or other representative, an office for the transaction of the business of insurance either in or out of Ontario, or that in Ontario distributes or publishes or causes to be distributed or published any proposal, circular, card, advertisement, printed form or like document, or that in Ontario makes or causes to be made any written or oral solicitation for insurance, or that in Ontario issues or delivers any policy of insurance or interim receipt or collects or receives or negotiates for or causes to be collected or received or negotiated for any premium for a contract of insurance or inspects any risk or adjusts any loss under a contract of insurance, or that prosecutes or maintains in Ontario an action or proceeding in respect of a contract of insurance, or a club, society or association incorporated or unincorporated that receives, either as trustees or otherwise, contributions or money from its members out of which gratuities or benefits are paid directly or indirectly upon the death of its members, or any of them, shall be deemed to be an insurer carrying on business in Ontario within the meaning of this Act.

Additionally, subsection 40(4) prohibits agents from assisting anyone from carrying on business in Ontario without a license:

40(4) No person in Ontario shall do or cause to be done any act or thing mentioned in subsection 39 (3) on behalf of or as agent of an insurer that is not licensed under this Act.

And lastly, just in case there was any uncertainty in subsection 39(3), section 123 deems any contract of insurance, having as its subject-matter, an insurable interest in Ontario property or an

Ontario resident, which is executed or delivered in Ontario, a contract which is subject to the laws of Ontario:

123 Where the subject-matter of a contract of insurance is property in Ontario or an insurable interest of a person resident in Ontario, the contract of insurance, if signed, countersigned, issued or delivered in Ontario or committed to the post office or to any carrier, messenger or agent to be delivered or handed over to the insured or the insured's assign or agent in Ontario shall be deemed to evidence a contract made therein, and the contract shall be construed according to the law thereof, and all money payable under the contract shall be paid at the office of the chief officer or agent in Ontario of the insurer in lawful money of Canada.

In order to avoid being deemed to be doing business in Canada, international insurers do not directly solicit Canadian residents, but they will respond to enquiries. Responses from these insurers are often sent to professional advisors such as lawyers or accountants. Some insurers will ask a prospective insured to undergo their medical exams outside of Canada and still others will not deal with a Canadian resident as the policyholder, but prefer to issue the policy to a non-resident trust. Many insurers avoid delivering copies of the actual policy into Canada, preferring to leave only pro-forma models with the insured/policyholder.

However, having stated the above, some foreign based insurers do not deem it necessary to take any of the above noted precautions to avoid contravention of the domestic legislation.

Investment of Premiums – International

One of the primary features of an internationally issued life policy is that the assets in the cash account can be individually managed. However, there are two very different approaches in respect of this feature. Under the first method, the insurer keeps the assets in its general capital and segregates the funds only in terms of custody and accounting. Legal title to the assets remains with the primary issuer of the life contract and these assets are at risk from other benefit claimants or third party creditors of the insurance company. Any risk that the issuer feels is beyond its capability to insure, or for which it may be obligated to off-load due to its regulatory regime, is re-insured by a reinsurance company.

The second method is for the issuer to step back and use a fronting company to issue the primary policy to the Canadian client. The fronting company then transfers the bulk of the premium payment to the originating company as a reinsurance fee, which the originating company segregates from its general capital, which segregation is protected by law (the law where the originating company is located, such as Bermuda, Barbados or BVI). The cash account in this instance can not be attacked by creditors or other claimants of the fronting insurance company or the originating company. The fronting company is at full risk for the MTAR stipulated level of coverage and charges the originating company the equivalent of a yearly term renewal premium.

Although risk exposure to the cash account is very different in each method, the investment management of the funds is performed the same way in that the Canadian client designates an investment manager, which is approved by the insurance company, and this manager manages the assets using an investment mandate agreed to with the client. The assets are required to be

invested in liquid securities that are usually traded on public exchanges, in order to accurately test the policy for MTAR compliance.

While the client may not be able to borrow his or her own assets from the policy, most insurers will allow the policy assets to be used as collateral for a third party loan.

Investment of Premiums – Domestic

With domestic policies, the cash account assets are pooled with other cash account assets and managed by an institutional manager. In some cases, the institutional manager itself is the name of the pool or fund, while in other cases the manager is just in the background and the theme of the pool is to track a particular genre of securities like "International Growth", or "US small cap" or an identifiable entity such as S&P TSX Composite Index. Who knows if the assets are actually in those investments; in some cases they are almost certainly not. The obligation of the insurer is not to specifically have the pool of assets in those securities, but simply to track the return on those securities and provide the policyholder with an equivalent gain.

In comparing investment regimes between domestic and international, domestic does not provide for individual management, only group pools. Second, domestic assets are all subject to third party creditor claims of the insurer, whereas in some instances, international insurers are able to asset proof claims against the cash account.

Solvency of Issuer and Recourse

In Canada both policyholders and beneficiaries have the right to sue an issuer. This is not necessarily the case in all overseas jurisdictions. Some international jurisdictions have specific language permitting beneficiaries to sue an issuer, but many do not. Moreover some jurisdictions have peculiar bars to a client obtaining his or her funds. For example under s.131 of the *Insurance Act, 1996 -32* (Barbados), the Supervisor of Insurance can prohibit the payment of a cash surrender value to a client where he or she feels that it would prejudice the financial stability of the insurance company. Further, a number of smaller countries do not have developed bankruptcy laws (if any at all) and very little case law to provide further guidance. Thus, creditor rights are an issue internationally.

Conversely, in Canada creditor law is well established. As mentioned above, policyholders and beneficiaries both have legislative standing to bring suit and more to the point, beneficiary benefits are fully or partially guaranteed in Canada through an industry body called Assuris. Death benefits up to $200,000 are 100% guaranteed. Death benefits exceeding $200,000 are 85% guaranteed. Cash or accumulated values of up to $100,000 are 100% guaranteed. Insurers licensed in Canada are required to be a member of Assuris.