

Doing It Right

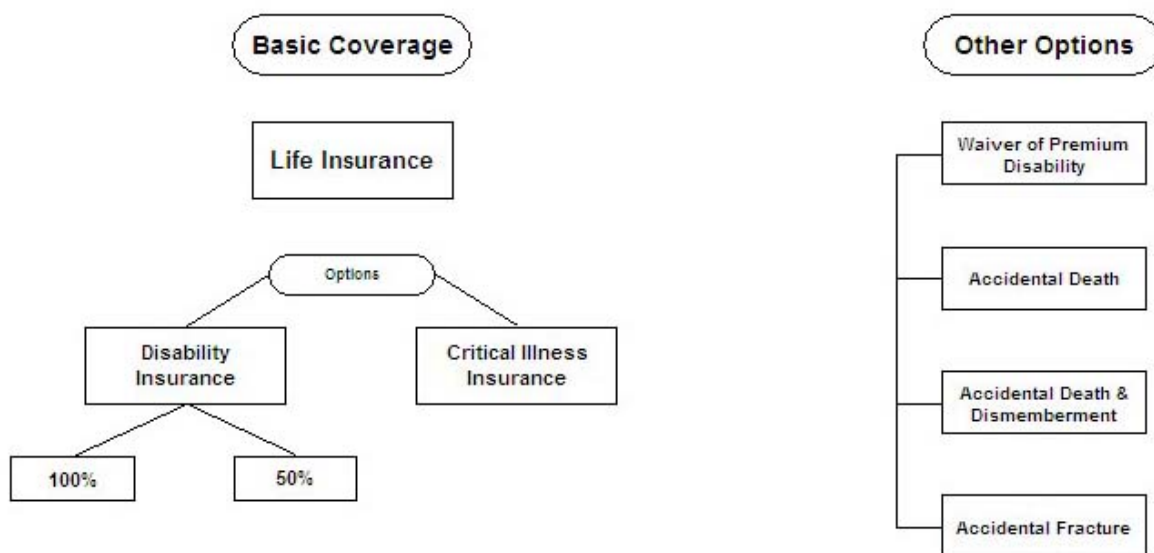
The
Canadian Financial Security
Program

Report on Mortgage Insurance in Canada

“Life, Critical Illness, and Disability Insurance on mortgages are often very misunderstood financial products, and many people don’t understand what they have purchased or what the alternatives are.”

SOME OF THE TOPICS COVERED IN THIS ISSUE

- Understanding the three mortgage insurance products
- The advantages of comparing the coverage offered by the lender to that offered by traditional insurance companies
- Other ways to cover your mortgage with insurance
- Do you really need it?



Introduction

In this report we will be discussing the **three main insurance products** that you should consider purchasing to protect your ability to repay your mortgage if you become ill or die prematurely. We will bring to light the substantial differences in what is available from banks and other lenders, and the products that you can purchase elsewhere. We will explore the advantages of purchasing your mortgage insurance from a **qualified Financial Advisor** who is able to help you properly quantify your risks.

Many purchasers have reported pressure being put on them to purchase these insurance coverages from the lending institution that supplies the mortgage funds. This is both a conflict of interest, and, in many cases, the promoting of an insurance product by someone who is not properly trained to evaluate your needs. We, at The Canadian Financial Security Program, take great exception to any situation where the purchaser is not clearly given **all the options** in a financial product, and where what is offered is not properly explained before purchasing.

If you have already purchased one or more of these insurance products from your mortgage lending institution, it is within your rights to replace it without any negative consequences. Indeed, after reading this report and taking a closer look at what you presently have, you may very well conclude that such would be very wise.

When we refer to “banks” in this article, generally speaking, we include credit unions, trust companies, on-line banks, etc. When we refer to “traditional insurance companies”, we are referring to the approximately 120 life insurance companies in Canada from whom you would normally buy your life insurance.

We do not wish to appear to be overly critical of banks in this report. In all fairness, a few of the banks do offer **some** good insurance products, and do employ **some** trained financial specialists, but for the most part they are not found in the branches where you would take out a mortgage. They are usually found in the bank’s “investment” division offices. Before you ever buy an insurance product, you need to make sure you are talking to a **licensed insurance specialist**, not a mortgage or loans officer. This is especially true of mortgage insurance if you wish to get correct advice on these products. Our concern is that most purchasers of these products buy them directly from the loan or mortgage department and never really have their needs properly evaluated. Also, most lending institutions have very limited products to cover these needs.

The biggest problem with all types of insurance, and this is no exception, is that most purchasers do not understand the coverage.

If you own mortgage insurance now, can you answer these questions?:

- What is the current cost of the coverage?
- What are you covered for: Life, Disability, Critical Illness?
- How, or to whom, are the benefits paid if you die or become disabled?
- How long is the premium (cost) guaranteed for?
- What will the cost be in 5 years?
- What will the cost be when you change age groups?
- If you refinance with a different bank or increase the loan, will the existing insurance be cancelled?
- In the disability coverage, how long will the payment be covered if you become disabled?
- In the definition of disability, what period of time is specified for “own occupation”?

The Three Mortgage Insurance Products

There are three main insurance products that you should consider purchasing to protect your ability to repay your mortgage. There are also a number of “riders” that can be purchased that can further reduce your risks, but those, for the most part, are only available from a traditional insurance company. None of the 5 major banks offered all three of these products at the time of this writing, but promoted only one (life insurance) or a combination of life insurance and one of the other two.

They are:

- **Life Insurance**
- **Disability Insurance**
- **Critical Illness Insurance**

Life Insurance

The basic mortgage insurance product that is offered by most major mortgage lenders, and of course, available directly from many life insurance companies, is “mortgage life insurance”. Life insurance, of course, pays a lump sum payment to a beneficiary on the (covered) death of the insured. Mortgage life insurance differs from other kinds of life insurance in a number of ways.

Mortgage life insurance is a “decreasing term” policy, where the death benefit is in direct proportion to the balance of your mortgage. As your mortgage reduces, so does the risk to the insurer. If you die during the term of the insurance, the amount paid is usually sufficient to pay off the mortgage balance. In some cases, if you purchase from a traditional insurance company, you can actually receive (or your beneficiary will receive) more than the balance of your mortgage, even double. Coverage purchased from a lending institution is usually set up to pay the balance only.

Joint and First To Die

If you are purchasing this product as a couple, you are offered the product as a “joint and first to die” life insurance. This means that you pay a higher premium than for a single insured, a lower premium than two single insureds, but the death benefit is only paid out on the first death, and the contract is terminated. This is the only option at the banks. However, with some traditional insurers, if the surviving insured is less than 65 years of age, he/she remains insured for a certain (usually 45-day) period. In the event of a simultaneous death, within that certain period, the face amount will be paid **twice**.

The Advantages Of Appointing A Beneficiary Other Than The Lender

More important than the cost, always look at how the claim will be paid if there is one. Banks will directly pay off the loan. Traditional Insurers will pay to whomever you name as beneficiary.

Why is that important?

At the time of death, the beneficiary (if other than the lender) could, for example, take advantage of favorable interest rates. If mortgage rates are low and investment rates are high, the beneficiary could choose to invest the money and make the mortgage payments from the investment income.

If the loan has not expired and the lender imposes a prepayment penalty, the beneficiary could decide to invest the money, make the usual monthly payments, and wait until the loan expires to pay off the balance in order to avoid any penalties.

Other situations could benefit the beneficiary if he/she were to receive the amount of money directly and this way cover other more urgent needs.

Guarantee On Premiums

Few people realize when they purchase this life insurance from banks that the premiums are **not** fully guaranteed. They may tell you that your premiums do not increase due to “age”, but they can certainly increase due to “mortality” (the percentage of insureds that die during a term). These products are sold as “group” insurance and thusly, can be increased at the sole discretion of the bank or underwriting company. You have **no guarantee** beyond a short period like one year, etc. So, if you buy this on price, you may be getting a better price for the first year only. And then, as you become accustomed to paying the premium along with your mortgage payment it can increase, and most people just keep paying without the knowledge that they may have other options.

Traditional insurance companies sell products that offer a **guaranteed premium for the life of the contract** - even **if you change lenders**, and **even if the interest rate increases** on renewal of your mortgage.

Conversion Privilege

Traditional insurers can offer clients the unique advantage of converting their contract to permanent life insurance of the same type of protection (individual or joint), at any time before age 65 and without evidence of insurability. The face amount for the new policy will be equal to the mortgage balance at the time of conversion. This feature is not available at banks with their regular mortgage insurance products.

Who Owns the Contract

With traditional insurers, you own the contract. With the banks, they own and control the contract, and can virtually change anything they like (within reason, of course).

Underwriting

This one alone should scare you enough not to buy regular bank mortgage insurance. In most cases, there is no underwriting done when you purchase the coverage as long as you answer a health (screening) questionnaire. So, when is the underwriting done to see if you qualify for a claim? **When you die!** In other words, the only time a qualified life underwriter (the person who decides whether you qualify for a benefit) looks seriously at your application, is when there is a claim. Do you want that kind of scrutiny applied when you are not even there to defend it?

When you purchase from a traditional insurer, they are going to underwrite your application **before** granting you the coverage. So, when you receive the policy, it really is an “approved and underwritten” policy. As long as you have not lied on the application or otherwise committed fraud, the contract will pay the claim in accordance with the contract.

Below is a summary of some of the advantages of using a traditional insurer for your mortgage insurance needs. This list covers life, disability and critical illness.

ADVANTAGES OF TRADITIONAL INSURANCE COMPANY OVER WHAT IS USUALLY SOLD BY BANKS OR OTHER LENDING INSTITUTIONS

Since such a product is an individual life insurance product, you would receive all the benefits associated with this type of product. The primary advantages are as follows:

- ✓ Proper evaluation of your unique personal needs
- ✓ Customized insurance coverage which may include a number of additional insurance benefits
- ✓ Control over the contract (you are the owner)
- ✓ Guaranteed, level insurance premiums for the entire term of the contract
- ✓ Ability to convert contract to permanent life insurance, with no medical examination
- ✓ Protection against premium increase due to increase in interest rates upon mortgage renewal
- ✓ Critical illness insurance rider (covering up to 20 illnesses)
- ✓ Disability definition of own occupation covers 24 months (instead of the usual 12)
- ✓ Remains in force if you change lending institutions
- ✓ Ability to choose the beneficiary (can be different than lending institution)
- ✓ Underwriting done at the time of application, rather than at the time of claim

Disability Insurance

Disability insurance, in the case of this product, covers your mortgage payments (in the case of a bank), or sends the equivalent amount of the payment to you (in the case of a traditional insurer) if you become disabled, as defined in the policy.

Only two of the five major banks offer disability insurance at this time, so in many cases, if you want this coverage, you would have to seek a Financial Advisor.

Coverage

In most cases there is a choice of 50% to 100% of the mortgage payment. The reasoning here is that if both a husband and wife work, and one becomes disabled, the other will still be able to contribute to the mortgage payment.

Benefit Period

If you become disabled, most bank plans will pay the benefit for either 12 or 24 months. Most traditional insurers offer two options: 24 months, or for the complete amortization period (up to age 65).

Waiver of Premium

Available with some policies, the disability insurance may automatically include a **waiver of full contract premiums** (life, disability and, where applicable, critical illness and additional benefits). The waiver of premiums applies when an insured covered under the disability rider becomes disabled. So, in this case, if you are receiving a disability payment for your mortgage, the plan also continues to pay the insurance premium as well.

If a person becomes disabled, most bank insurance will cover you for 12 months for “own occupation” (if you cannot perform your own job), then they will only continue to pay if you are unable to work at **any job** for which you are qualified. Most traditional insurers cover a benefit period of 24 months for “own occupation”. Don’t underestimate the importance of this.

Critical Illness Insurance

One of the newest insurance products on the market, and a very popular product these days, is critical illness insurance. This product pays a **lump sum** to the insured while living, if he/she is **diagnosed with** a covered illness. It is very difficult to compare prices on this product because of the variance of illnesses that the different products cover. With this option in the mortgage insurance package, there is a vast difference between what is offered by the banks and the traditional insurer.

The TD Canada Trust product covers only 3 illnesses, the Scotia Bank product covers 8, and many traditional insurers cover up to 20. When comparing this product you must read the fine print carefully.

Read the definition of a covered illness carefully. For example, a policy may not pay simply because you have been diagnosed with **any kind** of cancer. In most cases, it must be “life threatening” cancer. Also, read the exclusions whether purchasing from a lender or directly from an insurance company. The bottom line with this product is to **make sure you understand what is covered**.

Joint Insurance

The critical illness rider is available on a joint basis thus protecting two insureds under the same contract. In this case, the insurance is payable on the first positive diagnosis of a critical illness. When an insured is diagnosed with a critical illness, the face amount is paid to the beneficiary and the contract is terminated. With the bank coverage, that’s it.

However, with some traditional insurers, if the other insured is less than 65 years of age, he/she remains insured for a certain (usually 45-day) period. In the event of a simultaneous occurrence (critical illness diagnosed or death), within that certain period, the face amount will be paid **TWICE**.

Illnesses Covered

The medical conditions or critical illnesses covered under this product are usually as follows. Most lenders only cover the first three, one covers the first eight, but only the traditional insurers offer complete coverage. Be careful because the illnesses covered may also differ between insurance companies.

Cancer
Stroke
Heart Attack
Coronary Artery Bypass Surgery
Coma
Paralysis
Blindness
Deafness
Muteness
Major burns

Multiple Sclerosis
Dismemberment
Kidney Failure
Major Organ Transplant
Benign brain tumour
Occupational Injury - HIV
Motor neurone disease (Lou Gherig's disease)
Alzheimer's disease
Parkinson's disease
Cystic fibrosis

Limitations and Exclusions

Again, be sure to read the contract relating to the limitations and exclusions no matter whom you purchase from. You don't want to wait until you have a claim to find out what really is, or **is not** covered.

Other Options Available From Traditional Insurers

Many traditional insurers offer other options that cannot be purchased through lenders. Not all companies offer all these options. The main ones are:

- Waiver of Premiums in the Event of the Applicant's Disability
- Accidental Death (AD)
- Accidental Death and Dismemberment (AD&D)
- Joint Insurance (applicable to AD and AD&D)
- Double Indemnity Benefit (applicable to AD and AD&D)
- Accidental Fracture

Waiver of Premiums in the Event of the Applicant's Disability

This protection can be added as an option to the applicant's basic (life) coverage, provided he/she is not covered by the disability insurance because the "waiver of premium" is automatically included in the disability rider. This option waives (pays) the full contract premiums if you qualify for a claim.

Accidental Death (AD)

This benefit provides for an additional payment of the mortgage balance (payable under the life insurance coverage) if death is entirely due to accidental causes and (usually if) it occurs within 90 days of the accident.

Accidental Death and Dismemberment (AD&D)

This benefit provides for an additional payment of a percentage of the mortgage balance according to a "table of benefits" (payable under the life insurance coverage) if death or dismemberment (or loss of use) is entirely the result of accidental causes and occurs within (usually) 90 days of such an accident. (e.g. "loss, or loss of the use of: 2 limbs - 100% payment; loss of one hand or one eye - 50% payment, etc.)

Joint Insurance (applicable to AD and AD&D)

In the event that both insureds suffer a loss at the same time, some companies will pay the benefit for each insured.

Double Indemnity Benefit (applicable to AD and AD&D)

Any amount payable under this benefit may be doubled if the death or dismemberment (or loss of use) occurs as a result of injury from certain types of accidents (mainly while traveling on public transportation or in certain public places).

Accidental Fracture

This benefit provides for the payment of an indemnity if the insured suffers a bone fracture resulting from an accident. Each company uses its own "scale" of payment for this coverage.

Other Ways To Cover The Risk

There are other ways, besides "mortgage insurance" to cover your insurance needs when you take out a mortgage. And, mortgage insurance is not a "one-size-fits-all" product. What is best for you will depend on your age, smoking status, and true needs. This is why we always recommend that you visit with a **real Financial Advisor** who is trained in these products.

As pointed out, mortgage life insurance is a type of "decreasing term" insurance. Depending on your overall needs, age, and a few other things, you may be better off purchasing 10-Year or 20-Year Term insurance to cover this need. Most trained Financial Advisors would automatically compare this as an option and explain the difference to you.

If you die while covered with regular mortgage life insurance, the payout is in direct proportion to the balance of the mortgage loan, while Term insurance is going to pay out the full face amount throughout the full term.

If you have your mortgage almost paid off, say there is only a \$5,000 balance, and you die, that's all your beneficiary will receive if you have the regular mortgage coverage. On the other hand, if you had purchased a 20-Year Term product and died near the end of the mortgage term, the payout would be the full face amount - the same as when you purchased it.

Sometimes, especially if you are young, this option is very reasonably priced and can be a much better option.

Do You Really Need Mortgage Insurance?

There is a difference between what you need and what you want. Even after reading this, if you conclude you could live without it, you may still want to purchase the protection to reduce financial risk for your family. However, it is still good to be able to quantify and understand the risk.

Technically, if you have enough financial resources that if you (or in the case of joint insureds, one of you) were to die or lose your ability to earn an income, you could still make your mortgage payments and keep your house, then you really don't **need** the coverage.

Having said that, it is still a very reasonably priced bit of peace-of-mind for most of us, even if we have other financial resources. Just make sure before you buy, you understand what you are buying.

Understanding mortgage insurance is just another step in achieving true financial security for you and your family.

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