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Breaking the 10-Year Cycle: Insuring Long-Term Disability Benefits

By Stephen Frank, CLHIA

Massey-Ferguson. Eaton's. Nortel. At first blush these corporations do not appear to have much in common. Dig a little deeper though, and they highlight what has turned out to be roughly a once-a-decade event in Canada – an iconic Canadian enterprise falls into financial crisis and, because their long-term disability plan was not fully insured, hundreds of individuals on disability have either lost or had their benefits significantly reduced. This creates a severe financial and emotional burden for them as well as their families, since they often have few, if any, prospects of returning to the work force in the future.

Ensuring that Canadian employees covered by long-term disability plans continue to receive their benefits regardless of their employer's financial position is an important public-policy issue. Over the decades, policy makers in Canada have made successive attempts to address this issue, but only recently has significant momentum been achieved.

Canada's life and health insurance industry took a hard look at this issue in 2009 following the Nortel bankruptcy. The industry was primarily concerned with preventing a similar outcome for employees in another 10 years. After a careful review of the various options being proposed, the industry recommended that all long-term disability plans should be insured and started an active advocacy program to promote this approach to governments across the country.

The benefits of requiring long-term disability plans to be insured is compelling. When a long-term disability plan is insured, it is offered through a contract with a regulated insurance company. A plan sponsor (i.e., employer) would enter into a group insurance contract with a regulated insurer and pay premiums in exchange for transferring to the insurer the risk and financial liabilities for providing the long-term disability benefits. In order to meet expected future payment obligations, the insurer sets up a reserve fund that requires actuarial valuation and reporting, as is required by federal and/or provincial prudential regulation. As an added level of protection, insurance companies are required to hold excess capital in order to provide a financial buffer. This further ensures that the insurance company will be able to meet its obligations. In the event that more workers than expected experience disabilities and reserves become inadequate, the insurer's required excess capital is drawn on to support the reserves.

The key point, though, is that the insurer's responsibility with respect to disability benefits continues, even when the plan sponsor experiences financial difficulties or after the plan is terminated. Indeed, after a plan sponsor's bankruptcy, the insurer will continue to pay benefits for disabilities that began while the group policy was in force.

The industry was very pleased that the federal government took a leadership role in this regard. The federal 2012 Budget Bill contained amendments to the Canada Labour Code to require federally regulated, private-sector employers that provide benefits to their employees under long-term disability plans to insure those plans. The legislation was given Royal Assent on June 29, 2012, and the new requirements came into force on July 1, 2014. As a result, all federally regulated corporations in Canada must now have insured long-term disability plans.

Provincial uptake on this is critical as the bulk of Canada's corporations are incorporated provincially. Encouragingly, we are starting to see some momentum. For example,

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respond to the IRS's inquiry within 90 days, an additional $10,000 penalty for each 30-day period that elapses following the notice will be imposed.[15] Fortunately, these enhanced penalties are capped at $50,000 per year. Worse still, the willful failure to file form 8938 may result in criminal penalties.[16]

Conclusion

In simple terms the new U.S. procedures for electing U.S. tax deferral for RRSPs and RRIFs do not live up to their billing. While the rules do afford a better option for Eligible Individuals, many Canadian residents will not qualify because they have not filed any returns for one or more tax years. As such, these individuals will be left with little choice but to seek leave to file a late election pursuant the complex, expensive, and uncertain ruling procedure.

About the Author

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Endnotes

1 Revenue Procedure 2014-55.

2 Matthew Madara of Tax Analysts wrote an excellent article that took a critical look at the Revenue Procedure. Madara, Matthew *New IRS Guidance on Canadian Retirement Plans Has Drawbacks* 214 TNT 196-2.

3 Article XVIII(7).

4 By virtue of Treasury Regulation (herein the "Regulation") 301.9100-1(c).

5 Section 4.04 of the Revenue Procedures (herein the "Revenue Procedures").

6 Supra note 4.

7 Regulation 301.9100-3(e).

8 Regulation 301.9100-3(b)(1).

9 Regulation 301.9100-3(b)(2).

10 Section 6662 of the Internal Revenue Code.

11 Treasury Regulation 301.9100-3(b)(3).

12 Treasury Regulation 3019100-3(c)(1)(i).

13 Pursuant to section 6038D and 1.6038-7T(a)(1) of the Internal Revenue Code.

14 In Sections 2, 5.01, and 5.02.

15 Section 6038D(d)(2).

16 Treasury Regulation 1.3038D-8T(f)(2).

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Ontario announced in its 2014 budget that all Ontario corporations will be required to insure their long-term disability benefits and passed the needed amendments to the Insurance Act in July 2014. This new requirement will come into force following the development of accompanying regulations and the work to accomplish this is expected to begin this fall. The CLHIA continues to hold discussions with other provinces with the ultimate goal of ensuring that all corporations in Canada insure their long-term disability plans going forward.

Canada is making good progress towards eliminating the potential for future workers on disability to lose their benefits in the event that their employer experiences a financial crisis. This is a good outcome for all Canadians and, hopefully, with successful take-up across the country we can break the 10-year cycle.

About the Author

Stephen Frank is the Vice President, Policy Development and Health, at the Canadian Life and Health Insurance Association (CLHIA). Stephen is responsible for overseeing and advocating for the industry's extensive interests related to health and disability insurance as well as overseeing policy strategy development and analysis on industry issues. He can be reached at sfrank@clhia.ca.