

Read the Fine Print!

There is good reason why the Canadian Life and Health Insurance Association uses bold typeface to advise potential buyers of private insurance: “**Read your contract!**” It will help them understand why they may not be getting all the benefits to which they believe they are entitled.

While the warning is sound advice in general, it was meant to apply specifically to disability insurance plans. Here’s the problem. It arises around the links between private insurance and the Canada Pension Plan (CPP).

Basic public protection

The Canada Pension Plan was introduced in 1966 to provide a measure of protection to Canadian workers and their families against the loss of income due to retirement, severe and prolonged physical or mental disability, or death. Quebec operates a comparable program called the Quebec Pension Plan. Together, the two

plans cover almost the entire Canadian workforce, including the self-employed.

The Canada Pension Plan provides insurance against disability for virtually all working Canadians. It is an important means of sharing risk and protecting both individuals and society from the burden that otherwise would result from uninsured disability.

All contributing workers may be eligible for a disability benefit if they have made sufficient payments into the CPP for four of the past six years and if they qualify under the program’s definition of disability – which requires the impairment to be both severe and prolonged.

The disability benefit consists of two parts. One part is a flat-rate component (\$353.87 a month in 2001) payable to all beneficiaries. The second component is an earnings-related portion, equal to 75 percent of the retirement pension that the contributor would have received at age 65 up to a maximum \$581.25 a month

in 2001. The total maximum monthly benefit is \$935.12 in 2001.

Most beneficiaries do not receive the maximum disability benefit. Last year, the average disability benefit was only \$737.21 a month for men and \$625.15 a month for women. The difference in these average benefits reflects the fact that men's earnings are higher, on average, than those of women.

The children of CPP disability beneficiaries also are eligible for a children's benefit if they are under age 18 or between the ages of 18 and 25 and attending school or university full time. The benefit is not granted automatically; an application must be made.

The children's benefit is paid as a flat-rate amount worth \$178.42 a month in 2001 or \$2,141.04 a year. Payment commences the same month as the CPP disability benefit begins. Eligibility for the children's benefit ends the month of the disabled parent's death.

Additional private protection

In addition to this near-universal protection from the public pension system, some workers have access to private disability insurance coverage through a group plan provided as a work-related benefit. Contributions toward these plans are made on the basis of a formula that an employer, union or professional association negotiates with a private insurer.

Other Canadians who work for companies that do not offer group insurance plans – typically small employers – or who are self-employed – must purchase private insurance on an individual basis for disability coverage above

and beyond the Canada Pension Plan. These individuals are basically independent consumers who search the 'market' of insurance policies for the best package (in their view) they are able to find and afford.

While not all workers have private disability insurance coverage through group or individual plans, a substantial number are covered in this way. The Canadian Life and Health Insurance Association reported with respect to disability insurance that: "At the end of 1999, about 58,300 group contracts in force in Canada provided more than 1.8 million workers with short-term income replacement; 90,700 group contracts gave more than six million workers long-term coverage; and 807,200 contracts were purchased individually."

Why double coverage?

Workers with private disability insurance generally are required to apply for the Canada Pension Plan disability benefit if they potentially would qualify. One might ask why it is necessary to have private protection if insurance companies require application to the Canada Pension Plan for those potentially eligible. There are several reasons.

The disability benefit – even at its maximum level – pays no more than \$11,221 a year in 2001. Moreover, as noted, the actual average payment falls well below this maximum amount. Workers would be wise to have extra protection if possible.

Another reason to purchase additional disability coverage relates to the stringent definition of 'disability' in the CPP Act. Many workers with impairments and conditions that

may be disabling over the long term nonetheless do not qualify for a CPP disability benefit and must rely upon private disability insurance alone.

Under the current definition of disability employed by the Canada Pension Plan, applicants must have a disability that is both severe and prolonged. A severe disability is one that renders a person incapable of regularly pursuing *any substantially gainful occupation*. This requirement is different from a number of private insurance plans and even workers' compensation programs which refer initially to a person's inability to do his or her current job.

Under the CPP, a prolonged disability has to be long continued (usually more than 12 months) and of indefinite duration or likely to result in death. In short, the CPP requires that a person be out of the workforce entirely and effectively incapable of performing any work that would provide sufficient income for basic support.

Many applications for the CPP disability benefit are refused at the outset and there are a substantial number of appeals of initial decisions.¹ Private insurance may provide coverage for those workers refused under the CPP.

Private insurance also covers conditions that are disabling but that prevent individuals from working on a *temporary* basis. The condition is not so serious as to be debilitating over an extended period. For example, a worker may have suffered a heart attack and is unable to return to work for some time or go back to his or her former position. With time and/or retraining, the individual may be considered employable and is deemed not to have a disability that is severe and prolonged.

Some employers offer disability insurance to attract new employees and maintain their current staff. These additional benefits help employers remain competitive relative to other employers.

Finally, private insurance often makes payments more expeditiously than the Canada Pension Plan. The CPP disability benefit is paid only in the fourth month following the month in which the contributor became disabled. Such waiting periods are standard in long-term disability plans in order to differentiate between short- and long-term disabilities. The CPP disability benefit is intended only for individuals with long-term disabilities.

Better-off-working principle

In its public information materials, the Canadian Life and Health Insurance Association describes disability coverage in the following way: "Disability plans help replace lost income, sometimes supplementing benefits from the Canada/Quebec Pension Plans, Workers' Compensation and Employment Insurance. They pay a periodic cash amount (e.g., 70 percent of normal earnings)."

Each private insurance company has its own policies regarding the percentage of pre-disability earnings that it will insure and the treatment of income from other sources. Generally speaking, private disability insurance replaces between 60 and 85 percent of gross earnings (though income from other sources such as public plans is taken into account). A greater replacement rate sometimes is paid if larger contributions are made to the plan.

Some plans pay tax-free benefits while other private benefits are taxable. Generally, benefits are taxable when employers pay the insurance premiums. They are not taxable when employees pay these premiums.

Some private insurance plans are indexed to inflation while others are not. There is no legislative requirement for the indexation of private insurance plans.

Private insurance policies also differ with respect to the definition of disability protection they provide. The Canadian Life and Health Insurance Association points out that: “Definitions of disability vary from contract to contract, and whether or not your policy will pay you benefits may well hinge on how it defines disability.” This statement is followed by the “**read your contract**” caveat.

Clearly, the variations among policies can give rise to problems. At the same time, the diversity can be considered a strength. Any given plan can provide a composite package of benefits according to the preferences expressed by the purchaser – employer, union or professional association. The variations allow for the individualization of the policy – unlike public policies that apply the same formula to all who qualify (their unique strength).

While the private policies vary, there are several common practices. Private insurance companies typically operate on the principle that workers should not be financially better off on disability insurance than when they were working.

In fact, the Canadian Life and Health Insurance Association material states explicitly that: “Disability insurance coverage is a safety net woven from several sources: individual

insurance plans, government plans and group insurance plans (through an employer, union and/or association). These plans are usually coordinated to ensure benefits do not exceed your normal income. (If disability benefits matched or exceeded normal income, the incentive to return to work would be minimized.)”

In practice, the Canada Pension Plan is the ‘first payer’ for workers who qualify for the disability benefit. This role is consistent with the original intent of the Plan – which takes into account CPP’s relationship with other payers, including private insurers.

The private insurance industry claims that the premiums required for private insurance coverage are actuarially adjusted to take into account the fact that it acts, in many cases, as second payer. Insurance premiums would be higher than they are in the absence of the CPP.

The Canadian Life and Health Insurance Association further notes that: “Benefits from group or individual plans often are integrated with those from government plans so that benefits do not exceed a certain percentage of normal earnings.” This practice means that total income for persons with disabilities will not exceed their pre-disability earnings – regardless of whether the total income derives entirely from the insurance company or from a combination of Canada Pension Plan and private insurance top-up.

What all this means

The better-off-working principle means that Canadians who hold private insurance policies receive a designated percentage of pre-disability earnings. If they qualify for the CPP dis-

ability benefit, then the latter is deducted from their insurance entitlement. Their post-disability income level stays the same.

Whether or not an insurance company counts other income to the household (including the earnings of a spouse) as an offset against its disability benefit depends upon the arrangement that the employer has in place for the employees or the contractual agreement negotiated by the employer or the employees' representatives.

Some problems have arisen particularly with respect to the offset of the children's benefit. The implications of this fine print are significant.

Some insurance companies consider the benefit to be disability-related income. These companies include the value of the children's benefit as household income when calculating the amount of top-up they pay to the client. Other companies do not include the CPP children's benefit – basically considering it income in the hands of the child alone and not the family.

What is unclear is the extent to which companies inform customers about this offset practice when they purchase their policy. Indeed, many insurance policy holders know little of the fine print of their policy – which often is purchased on their behalf by an employer, union or professional association. In fact, it is possible that even the parties negotiating the plans are unaware of some of the details regarding the offset provisions.

It should be noted that the offset practice represents a fundamental difference in philosophy regarding the nature of the children's benefit. The Canada Pension Plan pays a benefit for the children of disabled recipients to help them offset child-rearing costs. The legislative intent

was to provide some support to families in which a breadwinner has lost the capacity to work in the paid labour market. The children's benefit is viewed as a means of *income support* to assist the household pay for essential needs.

Insurance companies, by contrast, consider the payments to their clients as a form of *earnings replacement*, not income support. If the primary goal of disability insurance is to replace earnings, then the insurance industry takes into account all disability-related income. In the industry view, the children's benefit is a payment arising from the presence of a disability.

Clearly, this philosophical divide as to whether the children's benefit should be deemed as a form of income support or as part of the earnings replacement formula makes a difference in how the offset practice is judged. In our view, the children's benefit should be neither considered nor treated as earnings to the household.

Open dialogue around this issue may help clarify the intent of the children's benefit and its associated treatment by the insurance industry. However, dialogue around philosophical difference is only a first step.

Improved oversight of the insurance industry by all sectors and consumers also is required. It is of interest that the Alliance Party put forward a proposal in the House of Commons on February 7, 2001, for the establishment of a legislative committee to prepare and bring in a bill that would create the position of ombudsman to oversee private disability insurers in Canada.

Provincial governments, which regulate the private insurance industry, should require insurance companies to disregard the value of

the CPP children's benefit – or any benefit paid in respect of children. The children's benefit should not be treated, under any circumstances, as an offset to household income. The benefit is intended explicitly to help families with child rearing costs. Its purpose and value should be entirely protected.

Employers, unions and professional associations negotiating group insurance plans should ensure that the plans they purchase on behalf of employees safeguard the value of benefits paid in respect of children. Employers, unions and professional associations also should become more knowledgeable about the impact of the various provisions within private insurance plans.

Finally, there is an important lesson for all Canadians. In shopping for a private insurance policy, consumers not only should read the fine print. They also should read between the lines.

Sherri Torjman

Endnote

1. In 1998-99 (the most recent national data published by the Department of Human Resources Development), 22,452 applicants for CPP disability benefits filed appeals at the first level – i.e., their applications were denied and they requested an administrative reconsideration of the decision. Of that total, 6,317 (or 28 percent) of the formerly denied benefits were granted. In that same year, 9,607 hearings were held at the second level of appeals (i.e., a Review Tribunal). By the end of 1998-99, there were 3,967 cases pending at the third level of appeals (i.e., the Pension Appeals Board). *It should be noted that not all appeals arise from cases involving private insurance.* These numbers reflect the total number of appeals for all problems related to benefits under the Canada Pension Plan – although 95 percent of cases that are appealed involve a problem relating to the disability benefit.

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1600 Scott Street, Suite 620
Ottawa, Ontario, Canada
K1Y 4N7
phone: (613) 729-3340 fax: (613) 729-3896
e-mail: caledon@caledoninst.org
website: www.caledoninst.org