Canadian Life
and Health Insurance
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Association canadienne
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The Role of Disability Income Insurance Plans in Canada's Disability Income System

Submission to the

House of Commons Sub-Committee on the Status of Persons with Disabilities

By the

Canadian Life and Health Insurance Association Inc.

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CONTENTS

EXECUTIVE SUMMARY

- Disability income insurance plans provide income replacement benefits, assist recipients to return to work, and are often combined with extended health care benefits.

- Disability income insurance plans cover more than 8.4 million Canadian workers.

- Total disability income insurance plan payments have almost doubled from $2.4 billion in 1990 to $4.8 billion in 2001.

- Total CPP(D) payments have been virtually constant since the mid-1990s. In 1994, total CPP(D) payments were roughly equal to total disability income insurance plan payments. By 2001, they were only 59 per cent as large.

- Only those disability income insurance recipients who suffer "severe and prolonged" disabilities may also qualify for CPP(D).

- Based on their initial disability assessments, some disability income insurance plan recipients appear likely to qualify for CPP(D) benefits, and are advised to apply for several important reasons, namely:

  i) All of them have contributed to CPP and are thus entitled to apply.
  ii) If they qualify for CPP(D), the period during which they receive CPP(D) benefits does not reduce the amount of their CPP retirement benefits.
  iii) Their overall disability incomes will increase over time by the full amount of CPP(D)'s cost of living adjustments.
  iv) Most disability income insurance plans are designed and priced on the assumption that such applications will be made.

- CPP(D)'s average monthly approvals have declined by 56 per cent since 1994.

- The majority of applications for CPP(D) are initially rejected (e.g., 57 per cent in 2000).

- However, many rejections are overturned on appeal.

- If their CPP(D) applications are rejected, disability insurance recipients who appear to suffer from severe, prolonged disabilities are often encouraged to appeal.

- For disability income insurance recipients, one factor contributing to the frequency of initial CPP(D) rejections is the fact that those applications only rarely include pertinent information from disability income insurance plans' disability assessments.

- During CPP(D)'s often lengthy assessment period, many disability income insurance plans advance estimated CPP(D) benefits to recipients and are subsequently repaid when CPP(D) makes a retroactive payment of benefits.

- The current arrangements for such advance payments are a major improvement over the situation that prevailed prior to the 1991 amendments to CPP legislation.

- The current arrangements for integrating disability income insurance plan benefits and CPP(D) benefits work well in the great majority of cases.

- However, there may be infrequent instances in which unanticipated taxes owing arise from the integration of benefits.

- Provincial premium taxes and provincial retail sales taxes on disability income insurance plans increase the cost of disability income insurance coverage for working Canadians by more than $330 million per year.

The industry respectfully suggests that the Sub-Committee may wish to consider recommending that:

i) **Subject to the appropriate consent of the CPP(D) applicant, relevant information from the LTD plan's disability assessment could be considered in CPP(D)'s initial assessment of the application for benefits.**

ii) **The Minister of Finance's new Technical Advisory Committee on Tax Measures for Persons with Disabilities should take into account the possibility of unanticipated taxes owing arising from integration of LTD and CPP(D) benefits in its assessment of disability-related tax measures.**

iii) **CPP(D) officials, CCRA officials and disability income insurance plan carriers should develop a protocol for improved information sharing and communication with recipients to ensure that recipients do not become unnecessarily confused and concerned about the tax consequences of CPP(D) lump-sum retroactive benefits received in the context of a taxable disability income insurance plan.**

iv) **Provincial premium taxes and provincial retail sales taxes on disability income insurance plans should be significantly reduced as quickly as possible and ultimately eliminated.**

I: INTRODUCTION

The Canadian life and health insurance industry is pleased to have this opportunity to contribute to the deliberations of the House of Commons Sub-Committee on the Status of Persons with Disabilities. The provision of income replacement payments to disabled Canadians is an important component of life and health insurers' activities and the Sub-Committee's interest in the industry's disability income insurance issues is appreciated. In that regard, the industry commends the Sub-Committee for its highly innovative e-consultation process on disability income issues. A significant number of life and health insurance companies participated, contributing some 80 responses dealing with a range of important issues related to disability income insurance programs.

The CLHIA, established in 1894, represents 71 life and health insurance companies, which together account for more than 98 per cent of the life and health insurance in force in Canada, administer about two-thirds of the pension plans in the country and serve about 22 million policyholders across Canada and almost 15 million elsewhere around the world. In 2001, CLHIA member companies provided disability income replacement benefits totaling $4.8 billion to some 250,000 Canadians.

This submission focuses on the role of disability income insurance plans in Canada's disability income system, with particular attention to the interaction of these plans with CPP disability benefits [CPP(D)].

The structure of this submission is as follows:

- Chapter II explains the roles and responsibilities of the key partners in disability income insurance plans;

- Chapter III describes the disability income replacement benefits and other benefits that disability income insurance plans make available;

- Chapter IV outlines the Canadian clientele of disability income insurance plans and the total payments made over recent years by disability income insurance plans;

- Chapter V examines the relationship between disability income insurance plans and CPP(D);

- Chapter VI deals with the advance payment by disability income insurance plans of the CPP(D)-equivalent portion of disability benefits;

- Chapter VII discusses some of the tax challenges faced by disability income insurance plans; and

- Chapter VIII provides conclusions.

II: ROLES AND RESPONSIBILITIES

This chapter explains the roles and responsibilities of the partners whose efforts and involvement make a disability income insurance plan possible: plan members; the plan sponsor; and the plan carrier. These are discussed with respect to both group disability income insurance plans, which account for 89 per cent of disability income insurance plan coverage, and individual disability income insurance plans, which account for 11 per cent.

Group Disability Income Insurance Plans

A group disability income insurance plan involves three primary parties: the plan members; the plan sponsor; and the plan carrier. The paragraphs below provide brief overviews of their distinct roles and responsibilities.

- The **plan members** are those individuals who are covered by a plan's provisions. At any given time, some may be disabled and receiving disability income replacement benefits provided by the plan. The rest are active members of the workforce. In a significant majority of plans, the plan members pay the premiums required to provide continuing coverage. In a minority of plans, the plan sponsor (see below) pays the premiums.

- The **plan sponsor** is the organization that makes available the disability income insurance coverage to the plan's members. In group plans, this is most often an employer. However, in some cases, the plan sponsor is a union or other type of organization, such as an alumni association, a professional association or a chamber of commerce. The plan sponsor is responsible for choosing the disability income insurance plan and its features, and usually assesses several alternative plan designs in terms of both the benefits offered and the cost, frequently with the advice of a professional benefits consultant. When the plan sponsor is an employer, the plan sponsor's human resources specialists work closely with the plan carrier to administer the plan.

- The **plan carrier** is the organization that administers the disability income insurance plan. In many cases, the plan carrier is a life and health insurance company. However, plan carriers may also include: third-party administrators; employers acting on their own to provide a self-insured group benefits plan to employees; pre-paid medical expense organizations; and fraternal benefit organizations.

Individual Disability Income Insurance Plans

Individual disability income insurance plans involve two parties: the plan member and the plan carrier. In effect, the plan member also plays the role of the plan sponsor, in that he or she selects a plan from among competing carriers, and pays premiums directly to the plan carrier.

III: DISABILITY INCOME INSURANCE PLANS

This chapter explains the disability income replacement benefits and other benefits that disability income insurance plans make available to Canadians. There are two types of disability income insurance plans: short term disability **(STD)** plans and long term disability **(LTD)** plans; details of each type of plan are given below. Their shared orientation to assisting return to work is discussed, as are the additional extended health benefits often provided with STD and LTD plans.

STD and LTD Plans

STD plans replace a percentage of pre-disability employment earnings—for example, 70 per cent—for periods less than one year in duration (e.g., six months). They are generally harmonized with sick leave, other employee benefits and Employment Insurance, providing continuity of income for the plan member who has suffered a disabling illness or injury. They also are usually harmonized with LTD plans to provide continuous coverage when the period of disability extends beyond the term during which STD benefits are payable.

LTD plans focus on longer periods of disability. LTD plans typically commence payments after the disabled individual has been off the job for a significant period, such as six months, and replace a specified percentage of pre-disability employment income, for example 70 per cent. LTD benefits typically run up to two years for recipients who are unable to perform their own occupations, and continue longer—in the limit to age 65 or the onset of retirement benefits—for recipients who cannot perform any reasonably comparable occupation. LTD plans are typically harmonized with STD plans, providing continuity of income for plan members immediately on the cessation of STD benefits.

Facilitating Return to Work

An important aspect of STD and LTD plans is their commitment to assisting recipients to return to the workplace, preferably in their own occupations, or—if this proves to be not feasible—in another. Consistent with this orientation, disability income insurance plans are designed to ensure that the recipients have a financial incentive to return to work in the sense that their disability income replacement benefits do not exceed their pre-disability employment income.

To support and assist recipients to recover and return to work, many disability income insurance plans also provide:

- Medical and occupational assessments to determine the severity and probable duration of the illness or disability and the nature of any assistance the recipient requires to recover;

- Rehabilitation services to assist the recipient to recover; and

- Disability case managers who work with disabled employees to improve their readiness to return to work.

These services increase the speed and likelihood with which disabled plan members return to employment. They also ease the process of re-entry and readjustment to the workforce following periods of disability.

Extended Health Benefits

Disability income insurance plans are frequently part of a group benefits program that includes extended health care coverage. Typically, the extended health care benefits that are particularly valuable to disabled individuals include:

- prescription drugs;
- special nursing services;
- ambulance services;
- wheelchairs and other assistive devices;
- artificial limbs, prostheses and medical appliances; and
- specified medical or paramedical services that fall outside government plans (e.g., services from chiropractors, registered psychologists, physiotherapists, massage therapists, osteopaths and optometrists).

It is important to note that disability income insurance plans—both STD and LTD—are made available on a voluntary basis in a highly competitive market. One implication is that there are many variations in the specific features chosen by plan sponsors. It is also important to note that many disability income insurance plans are provided as a result of the terms of collective agreements between employees and unions.

IV: CANADIANS COVERED AND BENEFITS PROVIDED

In recent years, disability income insurance plans have become an increasingly important source of protection for Canadian workers. This chapter examines the growing clientele of disability income insurance plans over recent years. It also examines the total amounts of disability income replacement benefits provided to Canadians over recent years, as well as their increasing size relative to total CPP(D) payments.

Coverage

Coverage of Canadians by disability income insurance plans has grown very significantly since 1990, as Table 1 shows.

Table 1: Disability Income Insurance Coverage in Canada

	1990	2001	Growth
	(number of plan members)		
STD	2,729,000	2,998,000	+10%
LTD	5,807,000	8,422,000	+45%

Source: CLHIA special survey (*Health Insurance Benefits in Canada*)

In 1990, 2.7 million Canadians were covered by STD income replacement plans. By 2001, STD coverage had increased by 10 per cent, to 3 million Canadians covered.

In 1990, 5.8 million Canadians were covered by LTD income replacement plans. By 2001, LTD coverage had increased by 45 per cent, to 8.4 million Canadians covered.

As Table 2 indicates, LTD plans are an increasingly important source of protection for working Canadians.

Table 2: LTD Coverage and the Canadian Workforce

	1990	2001
	(number of plan members)	
LTD	5,807,000	8,422,000
Employed workforce	13,084,000	15,077,000
LTD plan members as % of Employed workforce	44%	56%

Source: CLHIA special survey (*Health Insurance Benefits in Canada*); Statistics Canada

In 1990, LTD plans covered 44 per cent of the total employed workforce. By 2001, they covered 56 per cent.

Coverage by Province

As Table 3 illustrates, STD and LTD plans cover Canadians in every region of the country.

Table 3: Disability Income Insurance Coverage across Canada

	STD	LTD
Nfld	20,000	90,000
PEI	4,000	20,000
NS	33,000	190,000
NB	30,000	130,000
Que	876,000	2,070,000
Ont	1,159,000	3,580,000
Man	112,000	340,000
Sask	83,000	200,000
Alta	321,000	910,000
BC	354,000	870,000
Terr	5,000	22,000
Canada	2,998,000	8,422,000

Source: CLHIA special survey (*Health Insurance Benefits in Canada*)

Disability Income Replacement Benefits Paid

Disability income replacement payments to Canadians who are disabled have also increased very significantly since 1990, as Table 4 shows.

Table 4: Disability Income Insurance Benefit Payments

($millions)

	STD	LTD	Total
1990	$603	$1,826	$2,429
1991	612	2,083	2,695
1992	583	2,194	2,777
1993	577	2,271	2,848
1994	597	2,321	2,918
1995	629	2,414	3,043
1996	625	2,863	3,488
1997	658	2,869	3,527
1998	670	2,733	3,403
1999	809	2,984	3,793
2000	840	3,375	4,215
2001	857	3,901	4,758
% Growth since 1990	**42%**	**114%**	**96%**

Source: CLHIA special survey (*Health Insurance Benefits in Canada*)

STD payments grew from $603 million to $857 million, an increase of 42 per cent. LTD payments grew from $1.8 to $3.9 billion, an increase of 114 per cent. Total payments grew from $2.4 billion to $4.8 billion, an increase of 96 per cent.

The particularly rapid increase in total LTD payments confirms once again that LTD plans are an increasingly important source of protection for Canadian workers.

Distribution of Benefits by Province

Disability income benefits provided by STD and LTD plans are a source of financial support to disabled Canadians across the country, as Table 5 shows.

Table 5: STD & LTD Payments by Province – 2001
($millions)

Nfld	$ 52
PEI	16
NS	112
NB	78
Que	1,115
Ont	2,071
Man	130
Sask	86
Alta	385
BC	704
Terr	9
Canada	4,758

Source: CLHIA special survey (*Health Insurance Benefits in Canada*)

Relative Size of Benefit Payments: STD/LTD and CPP(D)

Disability income insurance plans and CPP(D) both play significant roles in Canada's disability income system, as do Workers' Compensation payments. As noted earlier, in 2001, disability income insurance plan payments were $4.8 billion. At any given time, roughly 250,000 disabled Canadians are receiving such benefits. In 2001, CPP(D) paid $2.8 billion in benefits to roughly 284,000 disabled Canadians.

As Table 6 indicates, the relative importance of STD/LTD payments and CPP(D) payments in Canada's disability income system has changed dramatically in recent years. In 1994, the total amount of CPP(D) payments equaled 99 per cent of the combined total of STD/LTD payments. By 2001, the total of STD/LTD payments had increased to $4.8 billion (i.e., 63 per cent increase) while total CPP(D) had declined slightly (i.e., three per cent decrease). As a result, by 2001 total CPP(D) payments represented only 59 per cent of total STD/LTD payments. Thus, while still important, total CPP(D) benefits are declining significantly relative to total disability income replacement insurance payments.

Table 6: STD/LTD and CPP(D) Payments

($millions)

	LTD & STD	CPP (D) Total	CPP(D) as % of LTD & STD
1994	**$ 2,918**	**$ 2,885**	**99%**
1995	3,043	2,799	92%
1996	3,488	2,779	80%
1997	3,527	2,770	79%
1998	3,403	2,793	82%
1999	3,793	2,835	75%
2000	4,215	2,760	65%
2001	**4,758**	**2,804**	**59%**
Aggregate change since 1994	**+63%**	**-3%**	

In this context, it is also noteworthy that the data in Table 6 also indicate that total CPP(D) payments were essentially constant at $2.8 billion from 1995 onwards. This virtually unchanging level of total CPP(D) payouts from the mid-1990s to 2001 contrasts dramatically with the strong growth in total STD/LTD payments (i.e., 63 per cent from 1994 to 2001).

V: LTD RELATIONSHIPS WITH CPP(D)

This chapter examines the relationship between disability income insurance plans and CPP(D). In this regard, it should be noted that STD plans, with their focus on income replacement over the short term (e.g., six months), have negligible interaction with CPP(D), which provides income replacement benefits in instances of severe and prolonged disability and typically only becomes payable after a lengthy application and assessment process. As a result, STD plans are not discussed further in this chapter, which focuses on the relationship between LTD plans and CPP(D).

Aspects of that relationship that are reviewed in the following sections include:

- How LTD recipients differ from, or overlap with, CPP(D) recipients;
- How LTD plans deal with the possible eligibility of some LTD recipients for CPP(D); and
- How LTD benefits and CPP(D) benefits are integrated if and when an LTD recipient also qualifies for CPP(D).

LTD and CPP(D) Recipients: Differences and Overlaps

All LTD recipients are, by definition, members of an LTD plan. In order to receive LTD benefits, they typically must, as a result of their disability, be unable to perform their own occupation during the first two years following approval of their claim, or any comparable occupation after that. As noted earlier in this submission, while LTD benefits are being paid, LTD plans frequently make available rehabilitative measures and other activities intended to assist the LTD recipient to return to work. While some LTD recipients do resume working at some point, others cannot. As a result, LTD benefits can be paid over extremely long periods – in some cases until the recipient reaches retirement age.

CPP(D)'s plan members include all active members of Canada's workforce (outside Quebec), including both those who are members of LTD plans and those who are not. Because all LTD recipients have been active members of the labour force before suffering their disabilities, all of them have contributed to CPP. Therefore, some LTD recipients also may be eligible for CPP(D) benefits.

It is important to note that CPP(D)'s criteria for receipt of benefits are different than those of LTD. To qualify, CPP(D) applicants must:

- have made CPP contributions in four of the past six years; and
- suffer from a "severe and prolonged" disability.

As a result of these differing criteria, there is a partial overlap between the recipients of LTD and CPP(D). Specifically, LTD recipients include:

i) some LTD recipients who do not qualify for CPP(D) benefits because their disabilities are not "severe and prolonged";

ii) some LTD recipients who do not qualify for CPP(D) because they do not meet CPP(D)'s contribution requirements; and

iii) some LTD recipients who also qualify for CPP(D) benefits because they meet CPP(D)'s contribution requirements and their disabilities are "severe and prolonged."

Determining Dual Eligibility

Although all LTD recipients have been CPP contributors, only the group described in iii) above receives benefits from both programs.

CPP is a universal social insurance program financed by compulsory contributions by workers (including the self-employed) and employers. As such, CPP—including both its retirement and disability income components—provides the foundation for the income security of its recipients, and is supplemented by other benefits—including LTD benefits—that may be available to them.

Virtually all LTD plans are designed to provide the level of LTD benefits that, combined with any CPP(D) benefits that may be payable, will provide at least the plan's overall target income replacement level (e.g., 70 per cent of pre-disability employment income). Therefore, determining whether an LTD recipient also qualifies for CPP(D) is an integral step in the process of determining the level of LTD benefits that is payable.

Disability Assessment

An LTD plan's initial assessment of an application for LTD benefits, which is conducted shortly after the plan member applies for LTD benefits, plays a key role in identifying whether the plan member may qualify for CPP(D) benefits. This assessment includes comprehensive medical and occupational information. When the assessment indicates that the recipient qualifies for LTD benefits, the possible outcomes with respect to CPP(D) eligibility are as follows:

i) In some cases, the assessment indicates that, based on the rehabilitation plan and other therapies recommended, the LTD plan member is likely to return to work in the foreseeable future and does not appear to qualify for CPP(D);

ii) In other cases, the assessment indicates that the LTD plan member suffers from a "severe and prolonged" disability, is unlikely to return to work in the foreseeable future, and may qualify for CPP(D) benefits.

When an LTD applicant's initial assessment indicates that he or she falls into the group described in ii) above, at the same time that his or her application for LTD benefits is approved, the plan member is advised (and may be required, depending on the terms of their LTD plan) to apply for CPP(D).

Most LTD plans are designed and priced on the assumption that such applications will be made. This assumption makes LTD plans significantly more affordable for plan members. Indeed, one estimate indicates that LTD plan costs could increase by as much as 45 per cent if such applications were not assumed. Especially given that plan members pay the premiums in most plans, this affordability impact is of major importance.

There are at least three additional reasons why LTD recipients who appear to qualify for CPP(D) should make such application:

i) All of them have contributed to CPP and are thus entitled to apply.

ii) If they qualify for CPP(D), the period during which they receive CPP(D) benefits is "dropped out" in computing their average pensionable earnings and does not reduce their CPP retirement benefits.

iii) Their overall disability incomes will increase over time by the full amount of CPP(D)'s cost of living adjustments.

CPP(D) Applications, Rejections and Appeals

Most initial applications to CPP(D) are, in fact, not accepted. In 2000, roughly 60,000 applications were made to CPP(D), of which 34,000—that is, 57 per cent—were rejected.

Many initial rejections by CPP(D) are overturned on appeal. For example, in 1999, 23 per cent of first-level appeals and 41 per cent of appeals to CPP(D) Tribunals were successful.

When LTD recipients who appear to suffer from "severe and prolonged" disability are rejected for CPP(D) benefits, the LTD plan sponsor and/or LTD plan carrier frequently encourages (and in some cases requires) them to appeal CPP(D)'s initial rejection.

With respect to CPP(D)'s initial decisions, it should be noted that at the present time, it is only in rare cases that information from the LTD plan's disability assessment is considered in CPP(D)'s assessment of the initial application.

The industry believes that CPP(D)'s initial rejections of applications by LTD recipients would be significantly reduced if, subject to the appropriate consent of the applicant, relevant information from the LTD plan's disability assessment could be considered in CPP(D)'s initial assessment of the application. This could also help to reduce the number of CPP(D) appeals and CPP(D)'s administrative costs.

As a result, the industry respectfully suggests that the Sub-Committee consider recommending that, subject to the appropriate consent of the applicant, relevant information from the LTD plan's disability assessment could be considered in CPP(D)'s initial assessment of the application.

Declining CPP(D) Approvals

In assessing the high level of CPP(D) rejections, it is important to note that the number of cases approved by CPP(D) has been dramatically reduced since the mid-1990s.

Table 7 presents the average number of new CPP(D) claims approved per month in 1980 and from 1990 to 2001 inclusive.

Table 7: New CPP(D) Claims – Average Monthly Approvals

Year	# Approved
1980	**2,147**
1990	3,235
1991	3,649
1992	3,721
1993	4,831
1994	**5,059**
1995	3,459
1996	2,392
1997	2,338
1998	2,462
1999	2,391
2000	2,144
2001	**2,200**
Aggregate change since 1994	**-56%**

It is noteworthy that:

- the number of approvals in 2001—an average 2,200 per month—was virtually the same as the number of applications approved each month 20 years earlier in 1980, when the average was 2,147 approvals per month; and

- Since 1994, average monthly approvals have declined by 56 per cent from 5,059 to 2,200.

This dramatic reduction in case approvals by CPP(D) no doubt largely explains the fact that, as mentioned earlier, total CPP(D) payments declined by three per cent from 1994 to 2001. Moreover, it also sheds light on the high rate of rejection of initial CPP(D) applications.

Integration of Benefits

In those cases in which an LTD recipient also becomes eligible for CPP(D) benefits, virtually all LTD plans are designed to integrate the payments from the two plans. The benefit integration arrangements in the LTD plan design are intended to ensure that the recipients' total disability income replacement payments attain at least the target income replacement level (e.g., 70 per cent of pre-disability employment income), while (in the case of many LTD plans) not exceeding a specified maximum disability income replacement level—the all-source maximum (e.g., 80 per cent of pre-disability employment income). These levels are set at less than 100 per cent of pre-disability employment income in order to maintain an incentive for the LTD recipient to return to work.

LTD plans use various benefit integration formulas, depending on the plan design chosen by the plan sponsor. A simple example is provided below. It relates to an LTD recipient who had a pre-disability employment income of $3000 per month (before taxes), is in a plan with taxable benefits and a 70 per cent income replacement target and qualifies for $700 per month in CPP(D) benefits.

In this example, the plan directly offsets 100 per cent of the initial CPP(D) benefits (but not subsequent cost of living adjustments) to determine the amount of LTD benefits that must be paid to bring the recipient's income to the plan's target replacement level.

Pre-disability income	$ 3,000 per month
Income replacement target (70 per cent)	$ 2,100 per month
CPP(D) benefit	$ 700 per month
Plus LTD benefit	$ 1,400 per month
Equals total benefits (equals income replacement target)	$ 2,100 per month

In this example, the LTD plan pays benefits of $1400 a month to bring the recipient's total disability income to $2100 a month, this LTD plan's applicable income replacement target of 70 per cent.

Integration of LTD and CPP(D) benefits works smoothly in the majority of cases, with the recipient's income the same or better than if he or she had not qualified for CPP(D). However, it is possible that there may be tax-related challenges in some cases. These are discussed in Chapter VII.

VI: ADVANCE PAYMENTS OF CPP(D) BENEFITS

As noted in Chapter V, some LTD recipients also become eligible for CPP(D) benefits. CPP(D)'s decision on whether an LTD recipient also qualifies for CPP(D) benefits virtually always occurs significantly later than the commencement of LTD benefits. Frequently, CPP(D) takes one year to 18 months to make a decision on whether benefits are payable, and longer delays (up to five years) sometimes occur.

This chapter examines the arrangements that have been developed to provide LTD recipients with both LTD and CPP(D)-equivalent benefits during this period. To set the stage, it first describes the situation that prevailed before these arrangements were implemented, prior to the 1991 amendments to the CPP legislation. It then reviews the arrangements that have been put in place since that time.

Pre-1991 Situation

Prior to the 1990s, LTD recipients frequently experienced problems as a result of the lengthy delays before they received decisions about their applications for CPP(D) benefits. At that time, some plan sponsors and plan carriers withheld payment of an amount based on the estimated CPP(D) payments to which an LTD recipient appeared to be entitled. During the CPP(D) assessment period, they paid only the level of LTD benefits that, combined with estimated future CPP(D) benefits, would provide the recipient with the LTD plan's target level of income replacement.

This approach, which was common practice before 1991, reduced the LTD recipient's ongoing income during the CPP(D) assessment period, thereby increasing the financial pressures he or she experienced during a period of life that was already difficult for many reasons.

If the recipient's application for CPP(D) was approved, the retroactive CPP(D) payments were provided in a lump-sum retroactive payment to the recipient by CPP(D). If the LTD recipient's application for CPP(D) was not approved, an equivalent retroactive payment was provided by the plan carrier.

During that same era, other LTD plan sponsors and plan carriers paid the plan's full target level of disability income (e.g., 70 per cent of pre-disability employment income) to LTD recipients from the outset while their CPP(D) applications were under consideration. Effectively, this provided the recipient with an interest-free advance equal to his or her estimated CPP(D) benefits. If CPP(D) ultimately approved the application and provided a lump-sum retroactive payment to such an LTD recipient, the LTD plan carrier would then request that the recipient repay the CPP(D)-equivalent benefits that the LTD plan had already advanced. Regrettably, in many cases the CPP(D) lump-sum payment had already been entirely spent. This led to various difficulties and deterred increasing numbers of LTD plan sponsors and carriers from making CPP(D)-equivalent advances during the CPP(D) assessment period.

Post-1991 Reform

In response to the increasing frequency of these unsatisfactory situations, in the late 1980s and early 1990s, CPP(D)'s administrators and the life and health insurance industry cooperated to find ways to better meet the income needs of LTD recipients during the CPP(D) application and assessment process, which continues to be lengthy.

A new system was developed that resolved the problems described above. This system required an amendment to the CPP legislation, which, when it came before the House of Commons in late 1991, was passed unanimously by all parties.

The system implemented in the wake of the 1991 amendments involves the following key elements:

i) **LTD plan carriers which enter into agreements with the Minister of HRDC and undertake to meet certain criteria become eligible to be designated for "assignment of benefits."**

ii) **When a recipient of LTD benefits from an eligible plan carrier applies for CPP(D), he or she is offered the choice of entering into an assignment of benefits agreement with CPP(D). This agreement specifies that, if and when the LTD recipient becomes eligible for CPP(D), only the amount of CPP(D)-equivalent benefits that were advanced by the LTD plan carrier during CPP(D)'s assessment period will be repaid directly by CPP(D) to the plan carrier from the CPP(D) lump-sum retroactive payment.**

iii) **LTD recipients who enter into such an agreement with CPP(D) are advanced the CPP(D)-equivalent portion of the LTD plan's target income level by the plan carrier (as well as receiving the LTD portion) throughout CPP(D)'s assessment period.**

This system works to the advantage of the disabled individual (and that of the plan sponsor and plan carrier involved), because it provides an advance of estimated CPP(D) benefits at no cost to the LTD recipient until the CPP(D) assessment process is complete, while also ensuring the eventual repayment of that advance.

Results of Post-1991 Reform

The changes implemented in the wake of the 1991 reform of the disability income system have been extremely effective in overcoming the problems previously experienced. In particular, this approach much better meets the income needs of disabled Canadians during the CPP(D) assessment period, which continues to be lengthy.

By the same token, opportunities always exist to improve the functioning of any such large-scale system. Some tax-related opportunities are discussed in Chapter VII.

VII: TAX ISSUES

As the Sub-Committee's previous deliberations have noted, the tax system and its provisions have a very significant impact on Canada's disability income system and on the financial well-being of disabled Canadians. Many federal and provincial tax provisions that are relevant to disabled individuals require reappraisal and, quite possibly, revision.

This submission does not attempt to provide perspectives on the broad range of disability-related tax issues that would benefit from a thorough re-examination. Rather, this chapter focuses on:

i) **Tax issues that may be relevant to integration of LTD/CPP(D) benefits.**

ii) **Provincial tax provisions that negatively affect the affordability of disability income insurance protection for Canadian workers across the country.**

Nevertheless, the life and health insurance industry shares the view that there are many other aspects of the tax system that are relevant to Canada's disability income system and affect disabled Canadians. For that reason, the industry commends the Minister of Finance's recent initiative to establish a Technical Advisory Committee on Tax Measures for Persons with Disabilities, and is currently considering how it can contribute constructively to the Advisory Committee's work.

Tax Provisions Re: LTD/CPP(D) Integration

Chapter V noted that there may be tax issues relevant to the integration of LTD and CPP(D) benefits on a going-forward basis. Chapter VI noted there may be tax issues with respect to lump-sum retroactive CPP(D) payments. Both of these are discussed below.

Integration of Ongoing Benefits

As noted in Chapter V, when an LTD recipient qualifies for CPP(D) benefits, an integration formula is applied to determine the appropriate level of subsequent LTD payments. After CPP(D) begins payments, on a going-forward basis the recipient receives separate payments each month from the LTD plan and from CPP(D). The CPP(D) benefits are always taxable, whereas LTD benefits may be taxable or non-taxable, depending on plan design. In taxable LTD plans, taxes are withheld at source and remitted to CCRA by the plan carrier. However, tax is rarely withheld at source on CPP(D)'s ongoing monthly benefits.

Generally, the taxable status of CPP(D) payments does not create unpaid tax liabilities as a result of the LTD/CPP(D) integration, because the recipient's income is often not in a taxable range at yearend. The tax threshold for disabled Canadians depends importantly on the level of the Disability Tax Credit, which may be adjusted based on the forthcoming recommendations of the Technical Advisory Committee. Moreover, LTD plan designs are available that take into account the taxes potentially payable on CPP(D) benefits.

However, there is a possibility that in some infrequent cases, the replacement of a portion of LTD benefits by taxable CPP(D) benefits might result in unanticipated taxes owing, especially when the recipient has investment or other income that puts his or her total income into taxable range.

The nature and frequency of such situations remains unclear and could usefully be taken into account by the Minister of Finance's Technical Advisory Committee on Tax Measures for Persons with Disabilities in its assessment of the Disability Tax Credit and other disability-related tax provisions.

For this reason, the industry respectfully suggests that the Sub-Committee may wish to consider recommending that the Minister of Finance's new Technical Advisory Committee on Tax Measures for Persons with Disabilities should take into account the possibility of unanticipated taxes owing arising from integration of LTD and CPP(D) benefits in its assessment of disability-related tax measures.

Retroactive Payments

As noted in Chapter VI, there may also be some tax challenges with respect to retroactive CPP(D) payments. These challenges are somewhat different depending on whether the LTD plan benefits are taxable or non-taxable. Both of these are discussed below.

When LTD benefits are taxable, the LTD plan carrier withholds tax on both the LTD portion and the CPP(D)-equivalent portion of benefits it pays to LTD recipients during CPP(D)'s assessment period. Thus, when CPP(D) determines that the LTD recipient also qualifies for CPP(D) benefits and makes a lump-sum retroactive payment to the plan carrier on behalf of the recipient, there should be no tax owing by the LTD/CPP(D) recipient on the retroactive benefits. However, this may not be apparent to or readily understood by some recipients. Improved communication among LTD/CPP(D) recipients, CPP(D) officials, CCRA officials and plan carriers could avoid unnecessary confusion and concern for recipients.

For this reason, the industry respectfully suggests that the Sub-Committee may wish to consider recommending that CPP(D) officials, CCRA officials and LTD plan carriers should develop a protocol for improved information sharing and communication with recipients to ensure that recipients do not become unnecessarily confused and concerned about the tax consequences of CPP(D) lump-sum retroactive benefits received in the context of a taxable LTD plan.

As mentioned earlier, when LTD benefits are non-taxable, the taxable status of CPP(D) payments is often not problematic because the LTD recipient's income is not in a taxable range. Moreover, some LTD plan designs take into account the taxes potentially payable on CPP(D) benefits.

However, there is a possibility that in some cases, retroactive CPP(D) benefits received in the context of a non-taxable LTD plan might result in unanticipated taxes owing, especially when the recipient has investment or other income that puts his or her total income into taxable range.

For this reason as well, the industry respectfully suggests that the Sub-Committee may wish to consider recommending that the Minister of Finance's Technical Advisory Committee on Tax Measures for Persons with Disabilities should take into account the possibility of unanticipated taxes owing arising from integration of LTD and CPP(D) benefits in its assessment of disability-related tax measures.

Provincial Tax Provisions that Affect Disability Income Insurance Plan Affordability

As noted in Chapter IV, over the past decade disability income insurance plans have been playing an increasingly important role in providing disability income protection to Canadians. Moreover, given the dramatic reductions in CPP(D) approvals beginning in the mid-1990s, and the fact that total CPP(D) payments have not grown in recent years, the coverage provided by disability income insurance plans is vital to the protection of Canadian workers.

In today's cost-conscious economic environment, the affordability of disability income insurance coverage is a significant issue for plan sponsors and for plan members. **Regrettably, provincial tax provisions are increasing the cost of disability income insurance for plan members and sponsors by more than $330 million per year.**

Given that plan members pay the premiums in a majority of plans, most of this comes right out of the pockets of Canadian workers.

In particular, the affordability of disability income insurance plans is adversely affected by:

i) **Provincial premium taxes**, which apply to disability income insurance plans (along with other life and health insurance products) in every province and territory (see Table 8). The applicable tax rates vary from two to four per cent in jurisdictions across Canada. The overall premium tax burden on disability income replacement plans in 2001 was more than $98 million.

ii) **Provincial retail sales taxes**, which apply to group disability income insurance plans (along with other group life and health insurance products) at a rate of eight per cent in Ontario and nine per cent in Quebec (see Table 8). Ontario and Quebec are the only jurisdictions in North America to levy such taxes. Together, they imposed a tax burden of more than $234 million on disability income insurance plans in 2001. It is worth noting in this context that, in contrast to Ontario and Quebec's imposition of retail sales taxes on group STD and LTD plans, these products are tax-exempt for GST purposes.

Table 8: Disability Income Insurance Plans
Premium and Retail Sales Taxes – 2001

Province	Premium Taxes		Retail Sales Taxes		TOTAL (millions)
	Rates (%)	Amount (millions)	Rates (%)	Amount (millions)	
Nfld	4.00	$ 2.0		$ -	$ 2.0
PEI	3.50	0.5		-	0.5
NS	3.00	2.7		-	2.7
NB	2.00	1.3		-	1.3
Que	2.35	27.3	9.00	86.5	113.8
Ont	2.00	43.1	8.00	148.1	191.2
Man	2.00	2.6		-	2.6
Sask	2.00 / 3.00	2.6		-	2.6
Alta	2.00	7.9		-	7.9
BC	2.00	8.0		-	8.0
Yukon	2.00	0.1		-	0.1
NWT	3.00	0.2		-	0.2
NU	3.00	-		-	-
Total Canada		98.3		234.6	332.9

These premium and retail sales taxes combine to increase the cost of STD and LTD coverage for working Canadians by a total of more than $330 million. In light of the obvious constraints on the availability of CPP(D) benefits, it is important that STD/LTD plans be as affordable as possible.

For this reason, the industry respectfully suggests that the Sub-Committee may wish to consider recommending the provincial premium taxes and provincial retail sales taxes on disability income replacement plans should be significantly reduced as quickly as possible and ultimately eliminated.

VIII: CONCLUSIONS

As noted in the introduction to this submission, the life and health insurance industry welcomes this opportunity to contribute to the deliberations of the House of Commons Sub-Committee on the Status of Persons with Disabilities and stands ready to provide additional information on any of the matters raised in this submission.

The industry respectfully suggests that the Sub-Committee may wish to consider recommending that:

i) **Subject to the appropriate consent of the CPP(D) applicant, relevant information from the LTD plan's disability assessment could be considered in CPP(D)'s initial assessment of the application for benefits.**

ii) **The Minister of Finance's new Technical Advisory Committee on Tax Measures for Persons with Disabilities should take into account the possibility of unanticipated taxes owing arising from integration of LTD and CPP(D) benefits in its assessment of disability-related tax measures.**

iii) **CPP(D) officials, CCRA officials and disability income insurance plan carriers should develop a protocol for improved information sharing and communication with recipients to ensure that recipients do not become unnecessarily confused and concerned about the tax consequences of CPP(D) lump-sum retroactive benefits received in the context of a taxable disability income insurance plan.**

iv) **Provincial premium taxes and provincial retail sales taxes on disability income insurance plans should be significantly reduced as quickly as possible and ultimately eliminated.**