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Best to arrange your own mortgage insurance

It won't run out at end of term - Illness could prevent a renewal

Where is the best place to buy mortgage insurance — from the financial institution lending the money, or an independent insurance agent? Most of the larger mortgage lenders offer borrowers the option to get life insurance along with their mortgage, and conveniently add the premium to the monthly mortgage payment.

In my experience, this option is rarely explained at the time of application, and the borrowers are often surprised when I hand them the bank's life insurance application forms, and tell them the bank would like them either to accept or decline coverage.

Although I strongly recommend that mortgage loans be life-insured, lawyers, mortgage brokers and bankers are not usually trained or licensed to sell life insurance. I tell my clients that I cannot advise them whether or not the bank's life insurance will meet their needs. In addition, a lawyer's office is not the ideal location to fill out a health questionnaire for the bank's life insurance program.

Recently I spoke to Paul Mandel, my own life insurance agent. He is associated with Independent Financial Concepts Group Ltd. (http://www.ifcg.com). He always advises his clients to have their own separate life insurance coverage, apart from the lender's mortgage.

Mandel explained that when you buy a policy with a life insurance company, you purchase your own policy and you own it. Coverage with a lending institution, he said, is part of a group policy owned by the lender, and the borrower has no control.

With your own policy, your premium is guaranteed and fixed in advance, but group policy premiums may be subject to fluctuations if the lender raises charges for the whole group.

Your own policy is for any amount of coverage you want. If you already have insurance, you can add the mortgage amount to your existing policy. Insurance with a lender, however, is for the outstanding amount of the mortgage loan, and reduces as the loan balance declines.

An insurance company cannot cancel or refuse to renew your own policy, but a policy married to your mortgage can be cancelled by the lender or the issuing company.

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Bank employees are not licensed or trained to look at the borrower's overall need for life insurance. Independent insurance agents and brokers examine the client's total insurance needs, and not just the payment of the mortgage.

One of the most important benefits of owning your own policy is the ability to switch lenders when the mortgage matures. If your policy is linked to the mortgage, it terminates if you refinance or pay off the mortgage. If you switch lenders but have become uninsurable for health reasons during the original mortgage term, your old coverage terminates.

The need for obtaining proper insurance advice at the time of arranging a mortgage loan is vividly illustrated by the case of Avco Financial Services Realty Ltd. v. Norman, a decision of the Ontario Court of Appeal earlier this year. (The decision is online at http://www.canlii.org).

In 1988, Barry Norman and his wife, Yvonne, secured a one-year second mortgage loan from Avco against their house in North Bay. They also arranged a life, accident and sickness policy with Avco. The mortgage and insurance were renewed for one year in 1989, but at the time of the second renewal in 1990, Yvonne no longer qualified for the insurance, because she had been diagnosed with cancer. She died the following year, and the property was eventually sold under power of sale when the mortgage went into default.

Avco sued Barry when the mortgage went into default, and he counterclaimed for negligence, alleging that Avco failed to explain that the insurance expired with each one-year term of the mortgage and had to be renewed.

At trial, the judge awarded Avco the losses on its loan, but reduced the amount by half because of Avco's failure to explain the insurance coverage. Barry had to pay the other half because he should have informed himself of the insurance details at the time of the first renewal.

The Court of Appeal dismissed Barry's appeal in April, 2003, and he has filed an application for leave to appeal to the Supreme Court of Canada.

For homebuyers, the lesson from the Avco and Norman case is to discuss your insurance needs in detail with a licensed broker or agent at the time you arrange your mortgage loan.

Bob Aaron is a Toronto real estate lawyer.