

Do You Have the Right Life Insurance?

Having adequate life insurance should be an important part of your financial planning. The type(s) you choose will depend on your needs and goals.

Life insurance was established to provide funds at death to cover funeral and burial costs, pay final expenses and debts, provide an income for dependents (especially those with dependent children or a spouse), and leave a legacy for children and grandchildren. In addition, it provides a means for tax-efficient savings.

Before we can explore the benefits of life insurance in more detail, it is necessary to first understand the main types of policies and how they work.

There are primarily two kinds of life insurance and you could have them for different reasons. You may find that a combination of the two is the best solution for your situation.

TERM LIFE INSURANCE

Term insurance provides coverage for a set term which can either be based on a number of years, such as one, five, ten or twenty years, or based on your age when the contract expires, such as when you turn 60.

The premium you pay stays the same for the duration of the contract. The sum insured is only payable if you die while the contract is in force. If you survive to the end of the period, the policy is then worthless.

At the end of the selected term, you can renew the contract for the same term without having to prove that you are still insurable. It gets more expensive as you get older. The premium will increase and will be calculated based on your age at the time of renewal. This increase can become expensive in later years. You may find the cost unaffordable as you get older. Also, some term policies are not renewable after a certain age.

Because you are buying a short term insurance policy, the cost is lower than permanent life insurance. It is something to consider if you want to protect your spouse and children at a low cost should something happen to you.

You may also consider purchasing it as an alternative to mortgage insurance. When you purchase mortgage insurance, the benefit decreases over time as your mortgage gets paid off. With term life insurance, the benefit remains the same until the term expires.

You may convert your term life insurance policy into a permanent life insurance policy at any time. Depending on the conversion options, the ability to convert to permanent life insurance without providing proof of health can expire as early as age 65 or 70. The premium will be calculated based on your age at the time of conversion.

PERMANENT LIFE INSURANCE

Permanent life insurance provides protection for your life, not just for a specific term.

If your mortgage is paid off and your kids have grown up, you may wonder why you need permanent life insurance since you have no dependents. You may want to consider it because, in addition to paying a death benefit to your beneficiary, there is also a cash value:

1. The cash values inside of your policy can be accessed to supplement your retirement income through a policy loan, partial surrender or loan strategy, if needed.
2. Any money invested inside a permanent life insurance policy grows on a tax-deferred basis, within certain regulatory limits. This is especially attractive if you have maximized both your RRSP and Tax-Free Savings Account (TFSA) contributions.
3. The cash values can be used to pay your estate taxes when you die so your beneficiaries won't have to pay the taxes on their inheritance. Keep in mind that life insurance proceeds in provinces other than Quebec avoid probate and estate taxes if they are made payable to a named beneficiary and not to your estate.

There are two kinds of permanent life insurance:

1. **Whole life** insurance policies have level and fixed premiums, usually payable for your entire lifetime, which can't be increased or decreased. The premium payments in the early years exceed the amount required so you basically are overpaying in the early years to subsidise your later years. You have no investment decisions to make as you are provided with guaranteed cash values.

There are two kinds of whole life insurance policies:

- a. Participating policies – you participate in the insurance company's profits and the plan pays out a dividend which can provide an increasing cash value and death benefit
 - b. Non-participating policies – these policies are lower in cost and don't pay out a dividend
2. **Universal life** insurance policies offer flexible premiums, a choice of level or increasing death benefits, and the ability to take premium holidays if you want to stop paying your premiums in the later years.

When a premium is paid, the money is deposited into an investment account, which you have investment control over. As such, you can end up with a significant portfolio depending on the investment decisions you make. The cost of your life insurance and administration are deducted from the investment account.

COST COMPARISON

As discussed, term life insurance costs less than permanent life insurance. Let's compare the annual ranges of rates on a \$100,000 policy among various providers for the two types of life insurance that are most commonly sold: Term Life and Whole Life.

	Term Life		Whole Life
	10 years	20 years	
Age 25			
Male	\$123 - \$166	\$138 - \$218	\$386 - \$864
Female	\$94 - \$137	\$115 - \$218	\$313 - \$736
Age 40			
Male	\$150 - \$298	\$206 - \$389	\$723 - \$1,525
Female	\$127 - \$244	\$163 - \$389	\$586 - \$1,231
Age 60			
Male	\$583 - \$1,645	\$1,213 - \$2,074	\$2,242 - \$4,330
Female	\$427 - \$1,645	\$823 - \$1,973	\$1,939 - \$3,248

Assumptions: Non-smoker in regular health in Ontario; as at November 2009 (www.insurecan.com)

Note: a male who started a Whole Life policy at age 25 would pay the \$386-\$864 annual premium for as long as the policy was kept current (e.g. age 60 and beyond) whereas the premium for a term life policy increases at the end of each term as you get older, regardless of the age that you first get the policy.

WHY YOU MAY NEED LIFE INSURANCE

The main reason many middle class families want life insurance is the need to provide a substantial lump sum to replace lost income if a parent or breadwinner dies.

Young families are often carrying large mortgages and are meeting the expenses of growing children. This is why it's important for them to choose a life insurance product that provides the desired death benefits at a much lower current cost, which is term life.

By the time many adults reach their fifties, their children are usually grown, their mortgage will typically be substantially paid down so they now have a good deal of home equity, and they will have accumulated other retirement savings. As such, the need for a substantial death benefit from a life insurance policy is much less important in later life.

So for many young couples, it makes sense to focus the bulk of their life insurance on term life which is more cost-effective at that time of their life when life insurance is the most important.

If you are younger, you may find it confusing when an insurance agent recommends whole life policies when an emphasis on term life would seem the better choice. Be aware that insurance agents typically get much higher commissions for selling whole life products and those commissions often can have an unfortunate influence on advice provided.

Business Owners

Successful business owners may want to pass their businesses on to their children. One strategy they may use is to buy life insurance equalling the amount of taxes your children will have to pay on your business when they inherit it. Otherwise, if your children cannot afford to pay the taxes, they may be forced to sell the business.

Business owners also purchase life insurance to fund partnership agreements. Upon the death of a business partner, their surviving family can be bought out with life insurance proceeds.

REASONS FOR OBTAINING LIFE INSURANCE

There can be many reasons for purchasing life insurance. Certain reasons are more prevalent at one life stage than another.

Goal	Early career 20 to 35 years old	Family 25 to 55 years old	Established 35 to 55 years old	At or near retirement
Provide resources for your children's and/or grandchildren's future		✓	✓	✓
Ensure your spouse's lifestyle is protected		✓	✓	✓
Cover a mortgage or other loan	✓	✓	✓	✓
Provide a tax-advantaged cash value component that can be used to help meet future financial needs or opportunities	✓	✓	✓	✓
Finance a business opportunity, a sabbatical or retirement			✓	
Provide a tax-effective way to supplement retirement income for you and your spouse			✓	✓
Plan for long term care needs in the future				✓
Provide your heirs or estate with the liquidity needed to pay final taxes, business taxes, capital gains and settlement costs to preserve as much of your estate as possible to pass on	✓	✓	✓	✓
Leave a legacy outside of your estate to your heirs or favourite charity	✓	✓	✓	✓

Your level of life insurance coverage may change as your circumstances and age change. You should review and update your policies every few years.

Disclaimer: You should always seek the advice of an expert to find out which estate planning strategies may be best for you.

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