

- *Client Information Summary* -

Types of Life Insurance and Their Proper Use

One of the principals for creating and preserving wealth is to manage the risk of loss of income. Thus, until an individual has created sufficient wealth to provide adequate income for their family in the event of death, it is vital to *manage* the risk. In most situations it is possible to *transfer* the risk to an insurance company.

Once you have identified the appropriate amount of insurance you require today, and the amount you will need beyond retirement, making the decision as to which type of life insurance best meets your specific requirements is the next task.

Term Insurance (1, 5, 10, 20 Year and to Age 65)

Term insurance is life insurance that is purchased at a specific cost for a specific period (1 year, 5 years, 10 years, to Age 65, etc.). It is insurance in its purest form, with no "savings component", thus there is normally no cash surrender value if the policy is cancelled.

- § Term insurance should be used when a *specific amount of coverage* is required for a *specific period of time* and when available cash flow relative to your personal financial strategy is limited.
- § Consideration must be given to choosing an insurance company that is financially secure, with "competitive rates" being a secondary consideration. For example, a company offering the best rates may be a company that is not regarded as being financially sound.
- § If future cash flow is anticipated to improve, term insurance could be acquired with an option to convert to permanent life insurance at a later date. If conversion is contemplated, additional care should be taken to choose a quality insurance company that offers quality products to which conversion may be available.
- § To determine which type of term insurance (1, 5, 10, 20 Year or to Age 65) would be the most cost effective for a specific situation, it's important to analyse the total cost of various plans over the course of the required time frame.
- § Features of the plan should include renewability, guaranteed renewal rates, and disability waiver of premium.

Optional Group and/or Term Life Insurance

Most companies and many professional associations as well as some trade organizations offer a form of optional group life insurance coverage to their employees and/or members. The coverage can normally be tailored to each individual's situation, similar to private term life insurance.

The premium for this type of coverage may be much less than that of personal life insurance. The reason for the reduced cost is partly because the benefits are sold on a "group discount" basis. Another contributing factor to the low cost is due to a degree of uncertainty relative to whether a member's family will actually collect benefits under the plan. This is because the group or association coverage can usually be cancelled at the discretion of the insuring company (if claims are excessive). Also, premiums are not guaranteed and thus can be increased at any time to offset any bad claim experience.

Association group coverage should be viewed as a method of merely "reducing risk", in comparison with private life insurance which "eliminates risk".

Term to 100

Term to 100 is the simplest form of *permanent insurance* (meaning that it is available for the whole of life) and provides a specific amount of life insurance, with level premiums, to a specified point in time. In some cases, premiums may be payable for life while in others the payment period might be reduced to 20 years or to age 65.

- § Term to 100 should be acquired when there is a long-term need for a specific amount of insurance (need beyond retirement) and limited cash flow is available after implementing your personal financial strategy.
- § Choose an insurance company that is first, financially secure and second, offers competitive rates.
- § Features of the plan should include guaranteed rates and disability waiver of premium (where appropriate).

Universal Life

Universal Life is a type of *permanent insurance* that is flexible. It can be adjusted to change with ongoing changes in lifestyle and other personal needs or requirements. It provides an initial specified amount of coverage that can be adjusted as required subject to various contractual limitations, depending on the insurer. Premiums can also be adjusted with cash flow changes (minimums and maximums apply).

Deposits can normally be made in excess of the actual cost of the insurance. These excess deposits are invested within the policy, attracting no tax on growth while the funds remain in the policy. There are guidelines relative to the maximum tax-exempt value that can accrue in the policy.

Investment options for surplus cash invested within the policy will vary with each insurance company, but can include a variety of deposit terms. The short-term performance of a universal life policy may be more dependent on fluctuations in interest rates than other types of permanent insurance (i.e. Whole Life).

- § Universal Life should be considered when coverage is required or desired beyond retirement, and there is a cash flow surplus after implementing your personal financial strategy.
- § Features of the plan should include guaranteed rates, and disability waiver of premium.
- § Choose an insurance company that has good long-term financial stability, competitive rates, flexible contract provisions, and a variety of investment options.
- § Universal Life should be considered as an alternative to whole life when flexibility is important.
- § Universal Life is normally less cost effective than Whole Life for someone over age of 50. Thus, Whole Life may be considered as an alternative.

Universal Life—Term to 100

Term to 100 is appropriate where there is the possibility of using the tax-sheltered savings aspect of the product and where cost is comparable to straight Term to 100.

Whole Life

Whole Life is also *permanent insurance* and can be less flexible than Universal Life. There are many variations of Whole Life, thus our comments will be confined to what is referred to as participating Whole Life, which means that the policy-holders participate in the upside of a company's ability to manage their reserves through the payment of dividends.

Premiums for this type of insurance are normally greater in the early years than the actual cost of the insurance. The degree to which the premium exceeds the actual cost of insurance will determine the long-term cash accumulation that takes place within the policy. Usually the higher the premium, the higher the cash value accumulation.

The actual long-term performance provided by this type of insurance is impacted by the actual results the insurance company achieves relative to their death claims and actual operating expenses.

However, the greatest factor governing performance of the policy are the investment returns on the surplus premiums collected that the company achieves. Any excess premiums collected by the insurance company are refunded to the policyholder in the form of a "dividend" which can be received in cash or reinvested to increase the death benefits and/or cash value of the policy.

The funds accumulating within the Whole Life policy are not subject to taxation provided the policy falls within prescribed limits categorizing the contract as an *exempt* policy.

- § Whole life should be utilized when there is a permanent, long-term need for coverage beyond retirement and when personal cash flow is sufficient to allow the maximum flexibility in the decision-making process.
- § May be acquired in concert with Universal Life or in place of Universal Life when flexibility to alter premium "deposits" and/or death benefits is not a major concern.
- § Financial stability of the company is a very important consideration, as well as the company's long-term dividend track record.
- § Features of the plan should generally include disability waiver of premium.

Hybrid Whole Life

Hybrid Whole Life is *permanent insurance* that is a combination of regular Whole Life and Term Insurance.

The actual design is typically for a base of Whole Life coverage to be put in place initially with dividends each year being used to buy term insurance for the balance of coverage needed. For example, there might be a \$50,000 base whole life policy with term insurance of \$150,000 for total coverage of \$200,000.

The actual amount of Whole Life coverage will increase through the purchase of additional paid up insurance each year with the portion of the dividend not needed for the term insurance. This results in the need for the term insurance to diminish over time to the point when 100% of the total coverage will be converted to Whole Life with no further term coverage being necessary.

This hybrid version of Whole Life was developed by insurance companies in order to provide permanent coverage at a more affordable premium than regular straight-up Whole Life. It is often referred to as "Enhanced Protection" or "Econo Coverage".

- § Hybrid Whole life should be utilized when there is a permanent; long term need for coverage beyond retirement and personal cash flow is not sufficient to allow straight-up Whole Life to be used.
- § May be acquired in concert with universal life or in place of universal life when flexibility to alter premium "deposits" and/or death benefits is not a major concern.
- § Financial stability of the company is a very important consideration, as well as the company's long-term dividend track record.
- § Features of the plan should generally include disability waiver of premium.

Joint 1st or Joint 2nd To Die

While not technically a type of policy, coverage can be arranged on more than one life using a single insurance policy. For example it would be possible to arrange a Joint 1st to Die Term to 100 policy that would pay the death benefit at time of death of the first person who was insured under the contract.

In some situations, it is more economical to purchase joint insurance on either a 1st to die or 2nd to die basis. Joint 1st to die is appropriate when capital is needed on the 1st death, such as a married couple, or perhaps two business partners in which the need would be eliminated after the 1st death.

Joint 2nd to die is appropriate when the need for coverage will only be applicable after both insured's die. For example, capital gains tax on a family cottage won't be triggered when the first spouse dies because of the spousal rollover provisions. However, on second death, all capital gains taxes will be crystallized and might even force the surviving family members to sell the cottage to pay taxes due.

Because the insurance company is exposed to a reduced risk, the cost of a joint policy may be less than individual policies on multiple insured's. This is particularly true in the case of Joint 2nd To Die situations. However, care should be exercised when this structure is used as flexibility is reduced with a joint policy in comparison with individual policies on each insured's life.

All or Nothing

You may get the impression that the selection as to which type of policy is most suitable is an all or nothing decision for one type of policy or another. This is certainly not the case. Your advisor merely views these various types of insurance as "tools" to do a specific job—namely provide the amount of coverage that you require, for the period of time that you require, and for the lowest possible cost.

Consequently, our recommendations for the right type of insurance for a specific situation are always made on a strategic basis, and often will include a combination of various types of insurance.

In Summary

Choosing the right type of life insurance can be a complicated decision. However, the decision becomes easier when you know how much you need, for how long you need it, as well as the current and future cash flow you can allocate without having a detrimental effect on your personal financial strategy.

Once these issues are resolved we can then use the Insurance Selection Process that is diagrammed below to formulate our recommendations.

Insurance Selection Process Diagram

The flow chart on the following page provides a summary of the thought process one needs to go through in selecting the right type of insurance.

The Insurance Selection Process

