

- Client Information Summary -

Life Insurance – Frequently Asked Questions

Q. Should permanent life insurance with cash values ever be considered as an investment?

- A.** Over the past years it's been fairly common for cash value insurance policies to be sold based on their "investment" merits. In part this has occurred because insurance policies enjoy a unique tax status. The net result is that there are some tax advantages when money is "invested" in the tax-sheltered environment of an insurance contract. In cases where the "cash value" of the contract will be paid out at time of death in addition to the death benefit, as is common with Universal Life, it may be valid to view the cash value component of the contract as an "investment".

Q. Should I buy mortgage insurance?

- A.** Using a strategic approach to identify your needs in the event of death recognizes the elimination of any outstanding mortgages on your personal residence, as well as any other liabilities against personal assets such as car loans, cottage mortgages etc. This would include personally owned insurance policies, group insurance benefits through your employer and insurance on outstanding loans with your lender. The coverage provided by lenders can be on a single life or may be joint coverage with benefits to be paid out upon the death of either insured. The most significant feature of creditor life insurance is that its initial up-front cost may be relatively inexpensive; however, it should be noted that rates vary from one lender to another and may not always be competitive. For a borrower who has minimal cash flow available, it may provide a low-cost way to cover a mortgage debt. However some of the negative aspects of this type of coverage are that as the insured, you do not own the contract and thus have no control over it. If you move your mortgage from one institution to another, you may find that coverage is not available. If you have become uninsurable since the original coverage was obtained. Also, the coverage under this type of plan declines as your mortgage is paid off but premiums don't automatically decrease. You, as the insured, must request your premium to be adjusted to reflect your declining coverage.

When a borrower is in a position where they have cash flow available after implementing their personal financial strategy, personal choice will allow for a more analytical analysis of the options available. Generally speaking, there are more cost effective insurance products to provide protection on a mortgage. However these may require a larger up-front funding commitment.

Q. Should I buy creditor life insurance?

- A.** As explained previously, a strategic approach recognizes any existing mortgages or loans against personal assets as well as any insurance maintained in relation to those liabilities. Creditor life insurance on car loans, personal lines of credit, etc. is an option worth considering but selecting the right type of insurance is based on a detailed analysis and review of the options available. Acquisition of any kind of insurance should be reviewed with your advisor to ensure that the right choice is made.

Q. Are commissions a consideration in selecting the type of insurance?

- A. Most personally owned insurance contracts have built into their structure a commission component so that the selling “agent” is compensated for their participation in the underwriting process. Typically, the commission paid is based on the premium paid, therefore if you select policy “A” with a monthly premium of \$100 or policy “B” with a monthly premium of \$100, the commission payable will likely be the same, or similar. If an analysis is not performed to identify the right type of coverage, it could well be that inappropriate coverage would be acquired that has a higher premium than would be appropriate. What’s important is that a proper analysis has been done to identify the right type of coverage for your situation, given your cash flow situation. If this is the case, the commission should not be an issue.

Q. Should I be concerned about the financial stability of the insurer?

- A. Yes, the financial stability of the insurance company that underwrites your life insurance is an issue of concern. Over the years the insurance industry has always touted their history in Canada in that “not one policy holder has ever lost a single dollar”. However, the demise of Confederation Life, one of Canada’s largest insurers was a good lesson—the need to be cautious. To address the concerns of consumers, in 1988 the insurance industry set up a protection program called the Canadian Life and Health Insurance Compensation Corporation (CompCorp). The protection afforded by this program is similar to that under Canadian Deposit Insurance (CDIC) in that deposits are covered up to \$60,000 and life insurance contracts are protected up to \$200,000.

Q. Should I insure my spouse who doesn’t work out of the home . . . or my children?

- A. When a spouse who doesn’t work out of the home dies, the economic loss caused is usually perceived as the loss of services provided, such as home making or child care. However, there are other losses such as loss of future Old Age Security Benefits or lost inheritances that otherwise would improve the family’s situation. The needs analysis performed as part of a comprehensive report is an analytical process that identifies both the short-term loss as well as long-term losses. Therefore, whether there is a need to insure your spouse who doesn’t work out of the home will depend on your overall situation. The analysis itself will provide the answer to this question.

When it comes to insuring children, it’s very much a personal choice. The economic loss caused by the death of a child is usually the last thing of concern at such a time. The overriding emotional issues are all that’s important and parents often indicate that they would never want to profit in such a situation. However, once a family has taken care of all other aspects of their personal financial strategy including being on target to achieve their financial independence objectives, have sufficient programs in place to take care of the family in the event of Mom or Dad’s death or disability, by choice a parent may wish to start an insurance program for their children. It’s common knowledge that insurance is less expensive the younger the insured. Thus a start up insurance program is sometimes initiated by the parents for their children’s future needs. While this is acceptable, it should never be contemplated at the expense of other financial objectives.

Q. When we look at our analysis in the event of death, a large need is identified. What about the possibility of remarriage? Wouldn’t this decrease our need?

- A. When doing an analysis in the event of death, all possible changes that can be anticipated and controlled should be factored in. For example, in some cases it’s identified that the current residence owned by a couple will be sold on the death of one spouse and a smaller home acquired. The proceeds realized from the sale of the house that remain after a replacement is purchased can then be utilized to fill shortfalls on death. This is a controllable event. For the most part it’s merely a matter of putting the house up for sale and asking a reasonable market price. The same is true if it’s decided that a cottage or other personal asset would be sold on death. However, when it comes to remarriage, it’s another matter. While a couple may be fairly young and think it likely that remarriage will take place, it is impossible to know if indeed this will take place, or if so, when. Thus, when identifying the needs of the surviving spouse, counting on an event like remarriage would possibly reduce the need but should be cautiously considered. While it might indeed happen, it also may not happen. Having sufficient coverage could mean that the surviving spouse then has a choice whether to remarry. With inadequate coverage, they may have no choice.

Q. Because I'm presently single and have no dependants, why would I need life insurance?

- A.** Buying life insurance is to cover a need that will crystallize in the future. However, a thorough needs analysis should look at your situation today and identify needs in relation to that situation. For this reason when an analysis is performed for a single person, with no dependants, rarely is any need for insurance identified. In such cases no coverage is usually recommended. However there may be extenuating circumstances that would dictate otherwise. For example, if a single person contemplates marriage and a family in their future, they may choose to begin a program, while young. However, as explained above, this would only be viable if they were on track to achieve all other aspects of their personal financial strategy. Another extraordinary situation where pre-mature acquisition of coverage may be warranted is in a case where a person has a family history of a medical condition that is likely to manifest itself in the future. If that medical condition will, in the future preclude them from acquiring insurance when they really need it, it can sometimes be wise to put in place a foundation of coverage that will be there even if you become uninsurable in the future.

Q. Is it true that life insurance proceeds are exempt from the claims of creditors?

- A.** Life insurance and related life company products may enjoy some special creditor proofing attributes under provincial insurance laws all across Canada, if the following conditions are met:
- ⇒ There must be a named beneficiary. Normally that's a spouse, child, grandchild or parent. If it's anyone else, the designation has to be irrevocable—it cannot be changed (subject to provincial legislation).
 - ⇒ Money placed with an insurance company must be in place for several years to avoid being up for grabs if the contributor goes. This is often extended if creditors can show that the money was needed to pay debts at the time of the contribution.

Q. How are life insurance proceeds taxed?

- A.** As previously mentioned, life insurance contracts have some advantages under tax law. Basically, as long as the contract stays in place and doesn't exceed the government guidelines regarding the amount of cash contained in the contract, the growth that takes place each year on tax-sheltered. If the proceeds of a life insurance contract are paid out as a result of death, the tax sheltering is complete in that tax is avoided altogether. If however proceeds are taken out of a contract through surrender, partial withdrawal or loan, the insurance company must perform a calculation to identify if any "gain" has occurred in the policy. If so, then there will be tax payable on that gain. The calculation is very complicated and must be done by the insurance company involved. Suffice to say that taxable dispositions on partial withdrawals, surrenders and loans usually don't occur until a contract is at least 5-10 years in age or where excess funding of the contract was done to the maximum extent possible in the early years.

Q. Why do I have so many insurance policies?

- A.** If the insurance industry is guilty of any of its touted shortfalls, it's probably the accusation that it sometimes sells people insurance coverage based on the premium the client can afford to pay as opposed to filling the client's needs for the right amount of coverage. This is why it's common to find people who own 5 or 6 policies having death benefits of \$5,000, \$10,000, \$25,000 or \$50,000 each. When the total coverage is added up, the death benefits under all the policies sometimes doesn't come close to really meeting the needs of the insured's family in the event of death.

It's easy to demonstrate that over the long term, permanent Whole Life insurance is the most cost effective, assuming you are buying the coverage as an investment. Also, insurance agents may sell a client "what they want", as opposed to "what they need". However, insurance should first and foremost do what it's intended to do . . . pay for what your family needs . . . when they need it. Doing anything less would be analogous to paying \$300 a year for a fire protection policy on your home for \$50,000 of coverage when your home is worth \$200,000. The logic of such a decision might be that the \$50,000 policy has less coverage, but after 20 years all your premiums are refunded with interest. Whereas a policy for \$200,000

also costs \$300 a year but you don't get any of your premiums back after 20 years. If your house doesn't burn down, the \$50,000 policy looks pretty good, but if you do have a fire, you would be out of luck! The important thing to remember is that insurance is insurance. Any "investment" merits must be viewed in the right context.

Q. Who do you recommend as an "insurance agent"?

A. Part of the appeal of utilizing a strategic financial advisor is having someone who will make recommendations based on their knowledge of your total financial and personal situation. When it comes to your needs for life insurance, this strategic approach applies as well.