

# LIFE INSURANCE

## WHAT'S THE ROLE OF LIFE INSURANCE?

Life Insurance serves one of two main purposes: it either is used to create an immediate estate or to conserve the assets of an estate. It's that simple.

In the past, there has been criticism of life insurance as a poor investment - that it compares poorly to mutual funds. While generally it is true that life insurance makes poor investments, it is equally true that investments makes poor life insurance. You see, investments and life insurance are two different financial vehicles.

It's like comparing a car with a boat. Mutual funds and life insurance are financial instruments just as a car and boat are modes of transportation. A car is not better than a boat, or vice versa - they simply serve different needs. The same holds true for life insurance and mutual funds.

## CREATING AN ESTATE

Your role as an Investment Advisor with TPA Financial is in helping to build wealth for your clients. Given time, with regular adequate deposits and adherence to a viable accumulation plan, you will help your clients to reach their accumulation objectives. The problem is that there may be barriers to delay or prevent your client from reaching those objectives. Here are some of the situations that your clients may face and how life insurance products can help.

**Time.** We all have the same amount. Historically, we know the performance of various investment vehicles over long periods of time. But the occasional depression, recession, natural disaster or war may contribute to a downturn in a client's short term investment rate of return. If death were to occur during one of these periods of poor returns, it would obviously play a major detrimental role in attaining accumulation objectives. When your clients have dependents who rely on them for financial support and there are not enough assets available to maintain that financial support, then life insurance is the *only* product that can fulfill that need.

There are many types of life insurance plans - term, term to 100 and universal life. Which type is best for your clients? The answer lies with the situation. When you design an investment strategy for your clients you complete a "know your client" and "risk tolerance" study. You would not suggest a high risk/high potential return investment strategy for an extremely risk adverse individual. It's the same with life insurance. The amount and type of insurance program is dependent upon the insurance needs of the client, as well as his/her temperament, risk tolerance, cash flow, financial objectives and other factors.

For clients with substantial needs (over \$500,000), who have family responsibilities and debts and are not particularly interested in leaving their future estates intact for their heirs, then a renewable term plan may be appropriate. Renewable term plans are available in 5, 10, 15 or 20 year durations. The renewable feature provides the clients the ability to "renew" their policies for an additional period, at attained age premium levels.

Two interesting trends are occurring in the renewable term market. First, life insurance companies are differentiating risk based on health, height and weight ratio, family medical history, cholesterol levels, blood pressure, smoking status, driving record and other factors, especially for 10 year renewable term policies over \$250,000 face amount. You may hear about them, as **Preferred Term** products. There may now be six or more risk categories, each with a different rate schedule, depending upon those differentiating factors. The second trend is currently tracking in the United States but may find its way into Canada. For renewable term plans in the U.S., the term premiums are guaranteed for the initial period only. The **premium structure is not guaranteed** upon renewal. Currently, in Canada most companies guarantee the rates of their renewable term plans for the duration of the policy.

For clients who have long term financial obligations (such as the ongoing care of a disabled child), a Term to 100 policy may be the best plan. It is also suitable for clients who want to know what their premiums will be for the future. With renewable term plans, the premiums will skyrocket at renewal over the age of 55; whereas a T100 plan generally provides a level premium structure for the duration of the plan.

Universal life has enjoyed the biggest growth of all types of life insurance plans in recent years. It provides both a protection and savings element within the same policy. The protection element may be either renewable term or T100 based. Recently, the investment options available in universal life plans has been expanded to include the mirroring of performances to the indexes of the TSE300, S&P500, brand name mutual funds and segregated funds. Higher MERs on these plans may be offset by the tax-free growth enjoyed by these plans.

Universal life plans are suitable for your more affluent clients who require permanent protection for estate planning purposes. Over time, UL policies may prove to be the least expensive policy, especially if these plans are "quick paid" by "max funding" in the initial years. This strategy calls for larger premiums to be paid in as little as four years. Future premiums can then be paid from the built up equity within the policy - with the added bonus of never having to pay income tax on the investment returns.

**Health.** For the majority of us, our good health is taken for granted. Although we probably know people who have suffered a serious illness or been involved in an accident, it is difficult to picture ourselves in their place. It's an unpleasant situation and for many of us we therefore simply ignore the possibility of it happening to us. Unfortunately, people do suffer heart attacks; contract cancer and are involved in accidents. They don't plan to have these events but they do happen.

There are a number of life products which are available to reduce the adverse *financial* impact of a prolonged disability. *Disability* (or Accident and Sickness) *Insurance* is available to replace a portion of someone's income. Normally, a maximum of 60 - 70% of predisability income can be insured should illness or accident prevent the insured from working.

Unlike death, the definition of disability can be interpreted in many ways. As an example, one definition of disability may be "an inability to perform the major duties of his/her regular occupation and not otherwise gainfully employed." Compare that definition with this: "disability must be severe and prolonged. Severe means your condition prevents you from working regularly at *any* job, and prolonged means your condition is long term or may result in your death." The first definition of disability is a "regular occupation" definition similar to most quality plans; the second definition is

that of the Canada Pension Plan. Which would you prefer? How long would your standard of living be maintained at its current level, if you were unable to continue working? If your answer is 6 months, consider a disability insurance plan that would start paying you an income after a 180 day elimination period. The same holds true for your clients. The longer the elimination period, the less expensive the premiums. Remember, however, that a 90 day elimination period means that the first cheque will not go into the hands of the disabled client for a minimum of 120 days. That is because the insurance company pays the monthly benefit one month *after* the elimination period. The benefit may also be held up since claims forms and medical reports must be submitted and assessed only after the elimination period has been satisfied.

If disability strikes, expenses may increase and/or family income may decrease. Expenses would include nursing care, medical equipment, medication, home and car modification, as examples. Income reduction would naturally result if you were no longer able to work full time. It may also occur if your spouse had to take care of you and had to take a leave of absence from his/her employment. *Critical Illness insurance* pays a lump sum of money at the time of an insured occurrence of a critical illness or event. Heart attack, stroke and life threatening cancer are the three most common occurrences and result in about 80% of claims. Since different insurance companies insure different occurrences, conditions such as occupational HIV, Alzheimers, Parkinsons or loss of limbs are available only with specific carriers. Other insured diseases may include kidney failure, blindness, multiple sclerosis, paralysis, coma, deafness and major organ transplant.

Critical Illness Insurance is of greatest interest to the self employed. For entrepreneurs, they can visualize the financial effects of a critical illness to the continuing health of their business. They know that a prolonged absence from their business due to by-pass surgery will result in a loss of customers and possibly result in an apprehensive bank manager prematurely calling their line of credit or loan. A Critical Illness Insurance plan may reduce the potential financial "hit". The lump sum benefit from this insurance may be spent in any way that the life insured chooses whether he/she is disabled or not.

Those of us over age 50 understand that health does not improve with age. Conditions such as diabetes and arthritis become more common. People are continuing to live longer with the advancement of medical knowledge and technology but the quality of life may not be as high. *Long Term Care insurance* provides the funds for specific daily expenses when the insured no longer is able to perform some of the normal daily activities, such as, eating, washing, dressing, and walking.

Long Term Care insurance is gaining more exposure as the population of Canada ages. All of us recognize that the degree of financial support for long term care from the provincial government will not be as extensive as in the past. As the leading edge of the baby boomers reaches retirement (and prime long term care age), this type of insurance will become much more popular and likely, much more expensive and difficult to obtain.

Living Benefits (disability insurance, critical illness & long term care) are available to those people who need it; can afford it, and; can qualify for it. You can help your clients to determine if they need it and afford it but it is the life insurance company's underwriters who determines if they can qualify for it. A sore back and a visit to the chiropractor will not affect a life insurance application but may very likely result in a "modified" disability contract being issued. An elevated cholesterol or blood pressure reading will be cause for concern for a critical illness application. Unfortunately, life products must be purchased when you are *healthy* so that the benefits are available when you are not.

**Opportunity.** People purchase life products every day. New parents purchase life insurance. Professionals purchase disability insurance products. Older, more affluent people purchase critical illness and long term care insurance. They just may not be purchasing it from you.

With the fall of the four financial pillars (banks, trust, investment and insurance), life products may be sold by the banking or trust community, as creditor insurance or by the investment counsellor. It no longer is the private domain of the life insurance professional. The scary part of all this is that if another professional - say the banker who sell your client a residential mortgage - sells him/her critical illness plan on that mortgage, it creates two problems. It does not allow you to sell your client critical illness insurance, a product he/she obviously believes is valuable; and secondly, increases the relationship that the bank has with your investment client. A leading Canadian financial institution sells life insurance to over 70% of residential mortgage applicants and critical illness insurance to over 40% of those same mortgage applicants. These are lost opportunities and potentially, lost clients for you.

Learn to educate your client on the full breadth of your services and products that you represent. Use newspaper clippings, product brochures and newsletters to arouse interest. Keep your eyes and ears open for changes in situation (such as a change in employment or family status) as an opportunity to ask probing questions on possible life product needs.

## **PRESERVING AN ESTATE**

Estate Planning has been defined as "an ongoing transfer of possessions and property to family members at death and ensures: property is distributed according one's wishes; maximization of after-tax income, and; build up of assets.

If you have done your primary function well, your clients will have built up substantial assets to provide for their personal income needs during their "golden years". At death, your affluent clients will normally have specific objectives for the distribution of the assets they have worked so hard to accumulate during their lifetimes. They may wish to pass on their business interests to one of their sons or daughters who has taken an interest and shown an ability to run it profitably and capably. They may want to pass on their substantial RRSP/RIF portfolios to their children or they may want to make sizeable contributions to their church or favourite charity.

In each of these cases, permanent life insurance may be the best option for the healthy, financially secure investor to meet their estate objectives. The proceeds from a life insurance program is *paid tax-free, probate free and normally free from attack by creditors*. Cash would be made available to pay for any income taxes resulting from capital gains, the recapture of capital cost allowance, or income from the collapse of a RRSP or RIF. The life insurance proceeds may be used to equalize an inheritance - such as in the case of one child inheriting the family business to the exclusion of the others. Proceeds of life insurance through the estate to a registered charity or church can even result in a tax credit to be used to offset income taxes payable on other estate assets, such as mutual funds appreciation or the increase in cottage value.

If your clients have substantial assets, it is likely that income taxes will be payable at death. You may be able to defer paying taxes, but they will have to be paid eventually. Life insurance may provide the least expensive way to provide liquidity to preserve an estate and fulfil the wishes of the affluent client.

## SPECIALIZED PRODUCTS

You also have the ability to offer life products for specialized needs. Here are some examples of life products and how they may be used to help your clients.

<b>Life Product</b>	<b>How they may be used</b>
Segregated Funds	Only life insurance companies and licensed life insurance personnel can sell segregated funds. For your clients who are risk adverse and want guarantees that they will not lose their capital, segregated (seg) funds may be the answer. Depending upon the company, between 75% and 100% of net deposits are guaranteed at maturity (normally every 10 years) and death. Hint: Have you considered a higher risk segregated fund for your wealthier, unhealthy clients?
Immediate Life Annuities	Immediate life annuities are sold only by licensed life insurance personnel and life insurance companies. Currently, banks are lobbying to gain the ability to sell life annuities but are being challenged by the life insurance industry to prevent this from happening. Immediate life annuities, normally a monthly income for life, comes either as registered or non-registered. Registered life annuities must be purchased from the residual benefit from a LIF (Life Income Fund) at any time prior to the end of the year in which the annuitant reaches age 80. If you have any clients who want to remain with the certainty of GICs and take the interest as income non-registered life annuities may be a much better choice. The advantage of non-registered life annuities, or prescribed annuities is that the payout (monthly income) is a blend of a return of capital and interest. From a taxation point of view the interest portion is level or constant, thereby providing a higher net income for the annuitant.
Employee Benefit Plans aka Group Insurance	If you are licensed to sell life insurance, you are licensed to sell Employee Benefit Plans. Although group insurance (may consist of a combination of life insurance, accidental death & dismemberment, health care (prescription drugs, semi-private hospitalization, major medical), dental care, long term disability insurance, travel insurance) can be a rewarding field, it involves a great deal of knowledge, time and effort for the larger groups. It is strongly recommended that you work with a competent group specialist to provide the best service for your clients. Your TPA Insurance Consultant can refer you to the specialist best suited for your group. For smaller groups ( 1 - 10 lives), you have the ability to provide flexible, competitive quotes yourself and your TPA Insurance Consultant can provide you with the assistance you need.
Travel Insurance	One of the growth areas for years to come will be in the travel industry. As the baby boomers age, it is predicted that they will spend more of their savings outside their province. With the

	<p>cutbacks in healthcare in Ontario and the skyrocketing costs of healthcare everywhere, it only makes sense for those who travel to purchase insurance to protect themselves from a costly medical bill. As a licensed life insurance practitioner, you have the ability to market this plan to your clients.</p>
<p>Mortgage Insurance</p>	<p>When the banks, trust companies and credit unions sell residential mortgages, they automatically offer mortgage life insurance, disability insurance and critical illness insurance. Up to 70% of mortgage applicants purchase mortgage insurance. It may not be in the best interests of the client to purchase it from the financial institution where they purchased their mortgage, however. What happens to the mortgage insurance if the payments go into arrears? What happens if the life insurance company who supplies the product to the financial institution severs the relationship? What happens if the mortgage is transferred at renewal to another financial institution? What happens if the life insured dies and the surviving spouse has more pressing bills to pay? In each of these cases, the client is out of luck. The mortgage insurance purchased as creditor insurance with the financial institution protects the institution from financial loss. The mortgage holder is the beneficiary, not the family of the mortgager. If the mortgage is in default, there is a change in life carriers, the mortgage is transferred or even if another house is purchased, the mortgager is likely no longer covered. There are strong arguments for purchasing individually owned mortgage insured, available through their life licensed TPA Advisor.</p>

## SUMMARY

Life insurance products play an important role in financial planning. Time, regular adequate deposits and an adherence to a viable accumulation plan will result in your clients reaching their accumulation objectives. For those people, unfortunate enough to get sick, have a serious accident or die, life insurance products can prevent a financial disaster from occurring and allow the family to continue living with dignity and pride.