

A Consumer's Guide to Life and Disability Insurance

(Includes Eight Money Saving Tips)

Life insurance comes in two types – temporary and permanent. Most people have some type of temporary insurance either as a term insurance policy, mortgage insurance, or group insurance policy (likely through work or an association plan like an automobile club). Some also have permanent insurance either in the form of whole life insurance, universal life insurance or Term to 100 Insurance. First, looking at term insurance.

Term Insurance

The purpose of this insurance is usually for a short term or temporary need (to age 55 or 65 while the family is growing up and you are saving for retirement. It is to provide cash in the event of your death so those who depend on you will have the money to:

1. Settle your debts – mortgages, loans (business & personal), remove guarantees, make up for the income you provided to the family – Remember the impact of inflation when doing this calculation. At 3% inflation, a need to supplement income by \$25,000 will grow to \$50,000 in 24 years.
2. Provide for children's education, marriage etc.
3. Complete the funding for your spouses retirement plan – very important and why many need some term insurance to age 65 – this can also be a consideration for those looking for permanent insurance as well.
4. For businesses, it can be to fund a buy/sell agreement or to provide insurance on a key employee to provide cash to find a new person, absorb the financial shock of the loss and have additional funds to pass on to the family. The best reason can be to replace bank life insurance on loans etc with private insurance at a savings of 50% or more!

You can see the temporary nature of this insurance. It has a specific relatively short term purpose, which will no longer apply by at least age 65. This insurance can be very inexpensive for the amount you are purchasing (\$1 million can cost between \$35 for a 25 year old in excellent health but a 50 year old smoker in reasonable health could pay over \$90 for just \$250,000 – it depends on age, sex and smoking habits).

It generally comes in 5, 10, 15, and 20, 25, and 30 year terms. This means that the premiums are guaranteed for that period of time and they will automatically renew at a higher rate for the next term period up to an age limit. For example, a 10-year term policy has guaranteed rates for the first ten years and then you can renew it for another ten years without a medical at a set rate contained in the policy up to age 75 for many policies. Do not renew it if your health is good as the renewal rates can be four to six times more than the premiums if you shop around for a new policy. The assumption is that you only renew if you are too sick to get a new policy.

Money Saving Tip #1: Over half the people renew term insurance and pay these high premiums – get a new policy – with preferred term rates it might be less than you were paying.

At one time, insurance premiums were divided into smokers and non-smokers. However, the companies now have statistics that enable them to determine those who are least likely to die based on lifestyle, family history and blood pressure and some measurements they get from blood samples, such as cholesterol levels. About half the people will qualify for a preferred rate. At the time of this writing, a 35 year old should be able to purchase \$500,000 for about \$26 per month at regular rates but preferred rates would be in the \$20 per month range. Some companies also offer a preferred smoker rate for those who would qualify for a preferred rate but they smoke.

Finally, there is the issue of convertible. You will see most policies are renewable which means you can renew them for another term of say 10 years and convertible. Convertible means you have the right to convert all or part of the policy to a Permanent Policy at any time during the term without a medical. You just pay whatever the rates are at the time of conversion. If your policy was issued on a preferred basis some allow you to convert on a preferred basis if they have preferred universal life insurance rates. This is an inexpensive option that is usually built into the policy cost and worth the extra price. A few companies will offer policies without this conversion option for a small savings. Also, the products that one can convert to differ widely amongst different companies so if conversion is something you are considering mention this up front.

Money Saving Tip #2: Ask for preferred rates. There is an example of the preferred questions on my web site at www.lifeinsurancequote.com

Money Saving Tip #3: There are significant differences between some companies in the percentage of people who will qualify for preferred rates ranging from under 45% to over 60%. Ask me about this.

Money Saving Tip #4: If you are a smoker of the occasional cigar or enjoy a pipe, some companies will consider you to be a non-smoker or offer special smokers rates. Make sure you get this rate.

It is not expensive to move the financial risks to your family of your death to an insurance company and it is the responsible thing to do.

Permanent Insurance

The second reason for insurance is for estate planning and retirement planning. The primary difference here is that the need is not temporary and you want the insurance to pay when you die – hopefully at a very senior age. About 40% of insurance sold is permanent insurance.

Many clients did not know they had a need until we had spent considerable time discussing what these people wanted to have happen on their death and discovered some major differences between what they thought would happen and what would really happen. While saving taxes was

an important issue, in many cases it was not the most important. Some other issues we addressed was how to structure things so that a second wife of husband would not strip out assets they wanted their current children to get, ensuring that if a child married and it did not work out that the inheritance was still with their child. The primary reasons for choosing this type of insurance follow:

1. To ensure you spouse will have sufficient money to retire even if you spend more than anticipated during your retirement - this was my reason for purchasing a permanent policy “I wanted to ensure that my wife or spouse has sufficient cash when I die to enjoy her retirement regardless of what we spend in retirement”
2. To guarantee that you will leave some money to children – do not use the beneficiary election within a policy unless you want your children to get all the money at age 18 – not a good idea. Ask what you should do.
3. To leave money to a charity – there are some very interesting tax strategies around charitable giving. Please email me for a brochure on this issue.
4. A major use is to provide money to pay capital gains or estate taxes so that your beneficiaries can keep the assets or property on your death and not have to sell some to pay the taxes. This does not apply to your spouse in most cases as assets flow to them tax-free.
5. There are also a number of sophisticated corporate and individual strategies for wealth preservation and creation. Check out www.wealthprotect.com for a comprehensive review of these strategies.

For example, two strategies are:

One tax planning strategy to transfer money in an RRSP (Canadian) which will be taxed at over 40% on death to an insurance policy that will pass tax free to the designated beneficiaries on death with no probate or executor fees. This is frequently done as part of the previous strategy for covering capital gains taxes – I have an article on this with an example using a joint last to die policy.

Maximize your pension. Many of those who have pensions will need to decide whether they want to set it up so their spouses will continue to get a pension (about 66 to 75% of your pension) when you die. Obviously, the pension will be a lot less if you choose this option, as the Pension Plan will have to pay out money for a longer period of time. For many, there are advantages to taking the higher pension (where it stops when you die) and purchasing a life insurance policy with some of the difference which will provide a pool of capital when you die you're your spouse to live on. I can email you more information on this if you wish.

Business owners use Universal Life Policies for a developing a corporate pension plan that is very tax advantaged

Business owners can also use a Universal Life Policy to get retained earnings out of a company on a tax favoured basis.

These are just a few of the uses for Permanent Policies. They can also be set up so that premiums are only paid for a set number of years – usually 10 to 20 years after which the policy is fully paid up or there are sufficient funds in it to pay the premiums for life. Term to 100 Insurance is frequently used when all you want is a basic permanent insurance policy that you pay for until you die and then the beneficiary collects the money. It is usually the cheapest solution for this need.

Whole life has been around for years. During the economic boom, it fell out of favour as returns achieved by Universal Life policies were much better, but recently, the stable conservative returns have become attractive and more whole life policies are again being sold.

Money Saving Tip #5: Permanent policies frequently have assumptions about the returns you will get within the policy for Universal Life or dividends for whole life. These are generally not guaranteed so be careful that they are reasonable and that you understand that if they are not achieved, the outcome could be very different from the illustration. Ask to see several illustrations with different assumptions so you understand what could happen.

Money Saving tip #6: Universal Life Policies also have various bonuses built in that can increase the returns by 1.5% or more under certain circumstances. These circumstances usually relate to how much you are putting into the policy (referred to as funding), and how long the policy has been in effect. There are very significant differences between companies so ask to see illustrations from several companies.

Money Saving Tip #7: Universal Life Policies may have an opportunity to purchase riders like Critical Illness or Long Term Care Insurance and term insurance. There can be some real tax advantages to doing this if you are able to over fund the policy or you have a large amount to put into the policy to start. The funds inside a universal life grow with no taxes on the profits. If you are paying for these other policies with funds outside a Universal Life policy you need to pay taxes on the income before you pay the premiums.

Money Saving Tip#8: A few companies now offer preferred rates for Universal Life Policies and if you qualify, the savings can be very significant. Also some companies consider minimal pipe and cigar smokers to be non-smokers.

While some uses of Permanent Insurance, such as providing extra cash for a loved one, is relatively straight forward, the use of an independent life insurance broker for most situations is recommended as many options are generally not known to the general public and even financial professionals like accountants and lawyers may not be familiar with some of them. These types of policies have some real benefits and should be considered. You are about to sign up to pay a lot of money for a number of years so ensure you get good advice. If your term insurance policy is convertible, you can convert to a universal life policy without a medical.

How much insurance do you need?

When calculating how much insurance you need for the family, consider the time period your dependents will need an income should you not be there to provide it. This will depend on the spouse's ability to earn an income, the ages of your children, your standard of living, and the financial obligations you have. A single person may not require any life insurance. Ask your insurance agent to prepare a Financial Needs Analysis to help you determine the amount you need. The single person should consider disability and critical illness insurance to maintain their independence in times of illness or disability.

Remember, the impact of inflation when doing this calculation. At 3% inflation, a need to supplement income by \$25,000 will grow to \$50,000 in 24 years. There is an excellent basic needs analysis calculator on our web site www.lifeinsurancequote.com.

The amount required for the business will depend on several factors

If family members are involved in the business? How easy will it be for them to find another similar paying job if the business fails? If other family members can take over the business, coverage is required to bridge the time required to recover and get the business going again. In addition, the bank would like to see the loans paid off, as they will be very concerned with the risks.

If the business has to be sold, the chances of getting anything near its value will be remote. It is also likely that there are personal guarantees on the business debts and other financial obligations like leases that will have to be met. Creditors can attack life insurance intended for the family if the wife has signed guarantees for the business, which is very common.

For example, if you have a lease for space or a bank loan that is guaranteed by the surviving spouse, the landlord and bank can come after the life insurance proceeds to satisfy the amount owed. I have seen where these unexpected business obligations exceeded the insurance and the family home had to be sold to meet them.

If the business is a partnership or corporation, it is important that there is buy/sell agreement in place including the life insurance to enable the surviving partners or shareholders to buy out the surviving spouse's interest in the company. Seek advice on who should own the insurance, as there are significant tax implications on where the ownership of this insurance lies – corporate owned or personally owned.

Disability Insurance

Whether you are a sole owner or have a partner, the financial risks to your business and family are very significant if you suffer a serious accident, injury or illness that prevents you from working for an extended period of time. Not only does your current income stop, future income also stops and, in most cases, many of the business and personal expenses continue. There are leases, loans, salaries and other commitments to be met and no income.

If you have Workers Compensation, it will pay a percent of your income but only 8% of disabilities are covered by workers compensation as the accident occurs off the job or it is an

illness. Further, these payments will likely fall far short of what you will need. One of the leading causes of divorce is long-term illnesses and the associated financial stress.

One way to provide some protection is with a good disability insurance policy. However, as it is designed to protect your income and if you are starting out, there is no income to protect. Consequently, you will only qualify for a minimal amount – \$1500 month. Be careful as there are policies available for whatever amount you want up to \$3,000 or more per month but they do an income test at time of claim and look at what your actual income was and they only pay out about 66% of this income regardless of the amount you were paying.

One consideration is to purchase a personal disability policy at least one year before you are planning to go out on your own based on your income at that time. The need for a year is that there is a question in most applications concerning your intention to leave the current employment within a year – a yes answer and you do not get the insurance. Ensure it is the type of policy that will cover you if you change jobs in the future and the monthly benefit coverage is underwritten when you take out the policy. This means they will pay what you have purchased and they will not do an income check at time of claim.

Disability insurance is a specialty and you need to talk to someone who has expertise in this area and it may not be the same person who sells life insurance. Ask about how you will be paid if you can do part of your job or as you come back out of your disability. There are residual or partial disability payments when you start back and they are unique and different. Further, do you want to wait 30, 60, or 90 days before payments start? The premiums are about twice the cost for 30 days compared to 90 days. This is another excellent reason to have at least 90 days worth of expenses available for an emergency in cash or short term investments.

Some disability policies will also cover your “out of pocket” business expenses such as leases and loan payments. You can add this rider regardless of how much income you have. Some also allow you to add a rider that will continue to make contributions to your RRSP if you are disabled which can be critical to your retirement as a small business owner.

Critical Illness Insurance

A new and very interesting policy called Critical Illness Insurance is also available. It will pay a lump sum of \$25,000 or more 30 days after you are diagnosed with a life threatening illness, such as heart attack, stroke, or cancer. Many people recover from these critical illnesses but not until they have gone through considerable emotional and health problems that causes significant financial stress. The premiums are lower than for disability insurance and the amount you purchase is not as limited by your income as disability insurance - \$200,000 or more is generally not a problem.

Many business owners will return to work within three months from most injuries or simple illnesses and would not collect much on a disability insurance policy. It is the critical illnesses that keep them off the job for more than three months and all the money is paid out after 30 days. For more information on this type of insurance you might want to visit www.critical-illness-insurance.com.

Finally, as the business grows and increases in value, you may want to consider either disability buyout insurance or critical illness insurance on each partner/shareholder so that if one becomes disabled and can not contribute to the company for a year or more there will be funds available to buy out their interest in the company. Few companies can carry an ill partner for an extended period of time – you need an exit strategy. Ensure that the conditions are set out in a shareholder or partnership agreement and that the funds to make it happen are will be there through insurance. It is an excellent way to get the company to pay for some critical illness insurance.

Finally, ensure that if you have insurance owned and paid for by your company, you have checked the tax implications with your accountant. When seeking advice on insurance, consult a well recognized insurance professional who has at least five years of experience.

For more information please call Russ Smart B.Comm. M.B.A
toll free at **1.866.238.9271**.

or visit his web sites www.canadas-best-mortgage-insurance.com; www.critical-illness-insurance.com or www.lifeinsurancequote.com.