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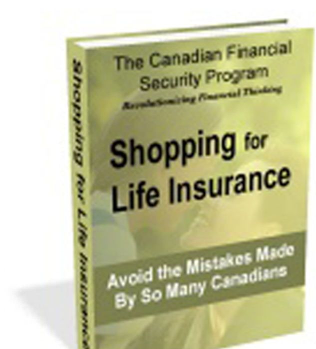
The Canadian Financial Security Program

Shopping for Life Insurance

Printer-Friendly and Online-Viewing Edition

Avoid the Mistakes Made
By So Many Canadians



Revised for 2012

Shopping for Life Insurance

Revised Edition – March 2012

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Introduction

It is an outrage to realize that sufficient "basic" life insurance can be purchased by a young family for less than what most people spend on coffee, and yet most Canadians are still underinsured. How did such a simple concept of "shared risk" become so filled with complications and confusion that the vast majority of Canadians either own the wrong kind, the wrong combination of Term and Permanent, or are underinsured. Generally speaking, the only reason that people with dependents think they can't afford enough life insurance is because they don't understand what they should buy. This publication is going to change that, at least for you.

There's an anecdote (and it's not funny) in the industry that the only time someone actually phones a financial advisor and asks to buy life insurance is on his way from the doctor's office after being diagnosed with a serious illness. The fact is this happens all too often. It's amazing how people can find money for things they "couldn't afford" when priorities are reviewed in such a renewed light.

Don't wait until this happens to you to make some of the most important decisions of your family's life. I say "your family's life", as opposed to "your life", very intentionally. Life insurance is probably the most unselfish thing we ever purchase. In its purest form, you, as the insured, will never directly enjoy the benefits of the coverage, except for the peace of mind that comes from knowing you have looked after your loved ones properly. But, when you consider the financial disaster that a family can suffer when income stops due to a sudden death, and the fact that it could have been averted so easily, this topic should be one of the top priorities in your financial life.

The purpose of this book is to help you understand the various products that can be used to cover the risk, and how to do it - adequately and for life, without wasting your hard earned money. Having armed you with this information, you will then have to deal with a licensed life insurance advisor in your province. In this, you have no choice. Only an individual who holds a license can sell you a life insurance product, whether that takes place over the Internet, which I would discourage, over the phone - not too bad if you are only buying term insurance, or from a qualified advisor who is willing to meet with you face-to-face and review your needs with you - by far, still the best way to buy life insurance properly as long as you are meeting with a financial advisor who truly has integrity.

YOUR NEEDS

Your Needs

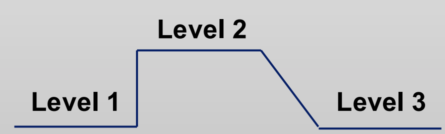
So that you will have a basic concept of what we are trying to achieve with life insurance, it is important in the beginning, that you understand the **basic life insurance strategy** taught through the Canadian Financial Security Program.

The Evolution of Your Life Insurance Needs

Level 1: Single / No Dependents

Level 2: Partner / Dependents

Level 3: Children are no longer dependent. You are alone or with a partner**.**



Although there are other things that crop up in life that may produce special needs, most people can categorize their **basic** insurance needs in **three distinct time periods**.

Level One: When you are a **single person** with **no others depending on you for support**. Do you need life insurance? Really, only for two things - to pay for your final expenses if you should die, and to pay off any debts that you might leave behind. Realistically, most young single people don't give this much thought or planning, so it is often up to parents to keep a small policy on their single, adult children because in most cases they are the ones that would end up being financially responsible if an adult child were to die.

Level Two: The moment that you become **financially responsible for someone else**, your life insurance needs change dramatically. As a matter of fact, you go from a very small need, to, for most people, the greatest life insurance need you will have in your life. For the majority of people, this is when you get married and/or have a child or children. If you take your responsibility seriously, you should have enough life insurance so that if you were no longer there to supply your family with their financial needs, then your life insurance proceeds should be able to do just that.

Level Three: When your family is grown and all responsible for themselves, and there is just you or you and your spouse to care for, your needs are sort of back to where they were at level one, except it is unlikely that your parents are there to pay for your final expenses. So, again, your needs are - enough to pay for your final expenses, any debts that you might have, and add to that any amount necessary to help insure the comfort of the survivor of your relationship for the remainder of his or her life.

Beyond these basic needs, there are a number of reasons that people sometimes buy "extra" life insurance such as a desire to leave money behind to cover the education of grandchildren, or simply to leave money to your adult children to help them have a less stressful life financially, however, these are “extra” and not necessary. They are good and honerable things to care for, but not obligatory like the other three.

Of course, we can’t plan for every variable, but we can plan for the basics and **the inevitable**. Some day, we all die, and someone will have to pay for those final expenses. Consider this: there is an ever expanding segment of the life insurance industry that is completely focused on supplying life insurance products to a very large population of **“seniors”** who, because they didn’t plan properly, find themselves in their 60’s and 70’s and have little or no life insurance and no other financial resources to pay for their own funerals. Now, they are scrambling to buy life insurance, which **if they can qualify for**, they are paying extremely high premiums for very small policies, sometimes with two-year waiting periods before the full coverage kicks in. You see, eventually, someone has to pay, even if it ends up being the government in the form of a welfare funeral.

So, the evolution of your life insurance needs will probably look something like this.

If you were to die today, you would need around $15,000 coverage to pay for your final expenses, plus an amount to cover any debts. That’s if you are single with no dependents.

Once you have dependents, you will need enough coverage so that the insurance proceeds **<u>can be invested</u>** and the interest or profit from those investments will give your loved ones enough to **replace the income** that you once supplied.

After your dependents are no longer “dependent” on you, you are back to the basic need again - final expenses and debt coverage, which, if you live a normal life expectancy, depending on your present age, could be a lot more than $15,000 when you do die.

Therefore, your life insurance needs could go from $15,000, suddenly to two, three or four hundred thousand or even a million dollars, and then back to 25 or 30 thousand dollars.

Now, there is a strategy, sometimes promoted by investment people, where you are encouraged to *“buy term and invest the difference”*. The plan here, as long as you are young enough, is to buy the cheapest term life insurance you can get and invest what you save by not buying permanent coverage in a good investment that will accumulate so much in the next 20, 30 or 40 years, that you will not need any life insurance.

In principle, it is a correct strategy that can work. However, in practice, it is turning out to be a dreadful mistake and a very high and unnecessary **risk** for most people who try it. If any of those “unexpected” things that crop up in real life force you to “stretch” your budget, it’s always the investment that gets postponed or withdrawn, and many people who followed this plan are ending up without reaching their investment expectations **<u>and</u>** with **no life insurance**. Again, this is why there is such a large market in non-medical life insurance at this time – because these people did not buy the correct life insurance when they were younger.

This is not unduly negative, just realistic. After all, we buy insurance to reduce “risk”. As you will see when you finish this book, the strategy taught here will cover the risk of the “unexpected”, just in case you still need a small amount of life insurance in your later years, without jeopardizing a good investment plan.

You will see that, indeed, the Canadian Financial Security Program, is all about creating financial security by proper investing, reducing taxes, and **managing** risk. You can’t possibly cover **all** the potential risks of life, but you can learn how to manage them sensibly and economically.

So, as we explore the different products and many decisions that you will face as you make financial choices in relation to life insurance, keep these basics in mind, and relate them to the products that are available to fill your needs in the best and most economical manner.

THE MAIN QUESTIONS

The Main Questions

Why buy life insurance? Basically, we buy life insurance to leave money to our loved ones when we die. Although many people leave behind life insurance when they die of **old age**, and it is a good idea to do so, it's more important function is to care for those we support if we die **prematurely**. We do this by buying enough life insurance to replace the income that we would have generated if we had lived. This sounds fairly simple. However, through the evolution of the life insurance industry, many products have become complicated and confusing. Other than basic "Term" coverage, most people don't understand some very important facts about life insurance. The purpose of this book is to help you understand those misunderstood facts and help you choose the kind of life insurance that is best for **you**.

There Are Three Main Questions To Be Answered Before You Buy Life Insurance

- How much coverage do need?
- What kind should you have?
- How much will it cost?

There are over a hundred life insurance companies in Canada and they each sell a variety of products. With hundreds of insurance products with hundreds of different names, is it any wonder that the general public is confused and doesn't know whom to trust. In the last fifteen years there has been a very positive evolution of insurance products, which I think speaks very well for the industry as a whole. Many companies are engaged in truly trying to supply products that really are what is "best for the consumer" and not just profitable for the company. But, how do **you** find what is really "best" for **you**? Knowledge is power, and we hope to empower you to be able to discern what **is** and **isn't** good for you for the rest of your life when it comes to this very important subject - life insurance to protect your most precious possessions, your family.

The Decision

As complicated as this topic may seem, keep the decision simple and remember there is generally only three things to consider when buying life insurance:

- **How much do you need?**
- **What kind should you buy?**
- **How much do you need to spend?**

How Much Do You Need?

How Much Do You Need?

To analyze your need you must consider the reasons for buying life insurance. The main reasons are:

- Replace your income for your family
- Pay debts
- Pay for final expenses

Some other reasons may be:

- Future education for children
- Leave extra money to loved ones
- Leave money to charity
- Estate protection

How Much Do You Need?

- Replace Income
- Pay Debts
- Pay Final Expenses

- Education for Children
- Extra Money
- Money for Charity
- Estate Protection

One time, to establish the amount you need to replace your income, the accepted formula was quite simple. You could take your annual income X 10, minus 25%. The plan here was to leave behind enough money for your loved ones **to invest** so that at a 10% return (yes – 10% was a reasonable expectation for many years for an average return prior to the late 1990's) they could receive the same income as though you were still able to provide for them. The "less 25%" was because expenses should drop by about 25% because you are no longer a consumer. Add to this "income replacement", an amount to cover your final expenses and pay your debts, and you would have had a rough total of your insurance needs. Then, along came the "financial crises", which really began in 1999, and this formula could be relied upon no longer as we all learned.

In this age of financial uncertainty, there is only one way for most people to establish their life insurance need with any accuracy and that is to sit down with a trained and qualified life insurance specialist who is licensed in your province and have him or her do a proper life insurance "needs evaluation study". Don't try to do it yourself unless you have proper financial training. The best you could hope for without a life specialist would be a good guess. The way the financial world has gone over the last decade or so has exposed the need for a good life insurance specialist or financial advisor like never before. Indeed, you cannot purchase life insurance from anyone who is not licensed, so why not find a good one. Don't buy life insurance from a TV ad, Internet "quote" site, or other "one-size-fits-all" method unless it opens the door for a personal evaluation, preferably with the advisor seeing you in-person.

SEE A TRAINED LIFE SPECIALIST OR FINANCIAL ADVISOR!

Also, there is an area of coverage which is much more complicated called “estate protection”. This is where you have accumulated a fair amount of assets or wealth and you wish to use life insurance to maintain the value of your estate on your death, especially in regard to taxes. For 90% of Canadians, the reasons already covered will encompass most of the needs, but for estate protection, you **absolutely** need a financial advisor and possibly an accountant and lawyer as well. Some of the more high-class financial firms actually have teams that include all these specialties, and you should consider this if your accumulated wealth warrants the expense and effort to protect it.

INSURANCE NEEDS WORKSHEET

In past publications, we included an “Insurance Needs Worksheet” based on the “old” formula. With some unease, we are leaving this worksheet in this publication just to give you an idea of how to **estimate** your needs and we have reduced the expected return to 6% (as stated, at one time 10% was acceptable). But remember, this simple formula was based on the belief that the survivor could, with some degree of comfort and certainty, invest the insurance proceeds in a financial environment in which it was reasonable to expect a “good” average return - something that has been almost impossible to count on or even predict in the last decade or so. Thus, the formula is of limited benefit in the current financial environment.

Also, don’t be shocked when you see how much life insurance you really need to care for your family if you die prematurely. The good news is that, “Term Life Insurance” is quite low in cost if you are fairly young (under age 45) and healthy, which is when you **should be** buying this amount of coverage. Today - $500,000, $750,000, or $1,000,000 in life insurance is both reasonable and affordable if you use the correct kind or combination of kinds.

Also, the “worksheet” does not consider the fact that your spouse (or whomever) may be generating his or her own income following your passing to contribute to his or her financial needs, so this is another factor that a good advisor will bring into play in establishing a reasonable need.

This will all come together more clearly in the next section when we discuss the “kinds” of life insurance and you understand how you can use both “Term” and “Permanent” coverage to look after your needs for both **“Level 2”** and **“Level 3”** periods of time, and (hopefully) you are doing it at a time when it is affordable relative to age and health.

The reason we do not cover **“Level 1”** on the worksheet is because during Level 1 you would have no responsibilities other than your own final expenses at this point in your life, therefore – technically, a $25,000 policy (plus any amount to cover uninsured debt) is all you really need. You may want to buy more to lock in a low price while you are young, possibly because you see such responsibility in the near future, but you do not **need** it yet. As we keep saying, this is why you need to talk to a life insurance specialist to properly evaluate your needs.

Why You May Need Investing Advice for Life Insurance

Whereas this publication takes the complications out of life insurance for the average Canadian, we must inject here that **investing** has become more complex than ever in history. And, you need to realize that there is a need for **investing knowledge** when it comes to the most important reason to buy life insurance – to replace lost income, not so much when you purchase life insurance, but if the unexpected does occur and your loved ones then need to deal with the "other side" of life insurance – collecting the proceeds because you have died. At that point, someone needs to know **how to handle** that sudden influx of a large amount of money so it will provide what you intended – enough money to support your family without your income to support them, and that requires **investing the proceeds effectively** to provide that income. For that, most people **need** the advice of a trained and skilled financial advisor.

Investing the proceeds of life insurance after your passing should absolutely be considered a topic for discussion unless those that might survive you have their own resources to assist in this matter. In other words, maybe they are quite capable of handling a sudden large lump sum of money and would make sure it is properly handled to serve its intended purpose – **or, maybe not.** This is not to suggest you need to "control" your insurance proceeds should you die prematurely, but you should consider and discuss the topic with those who would inevitably control it should you be suddenly removed from the picture. After all, that's why you're buying it. Most of us have heard the nightmare stories of people receiving large sums of insurance proceeds and mishandling it so it does **not** fulfill its intended use. Some people just spend the proceeds and then are right back to a financial crisis. It happens all too often. Give it consideration and discussion.

LIFE INSURANCE NEEDS WORKSHEET

(Level 2 and Level 3)

LEVEL 2 – PRESENT FAMILY NEEDS

Annual Income ____________ X 16.7 (6% projected return) minus 25% = ____________ (a)

Basic Need ____________ (a)

Add:

Uninsured Debts ____________

Final Expenses ____________

Education Fund ____________

Extra for Family ____________

Charity ____________

Miscellaneous ____________

TOTAL FOR ADDITIONAL COVERAGE ____________ **(b)**

Needs for next ______ years = ____________
Total of (a) and (b)

LEVEL 2 – NEEDS AFTER FAMILY HAS GROWN

Uninsured Debts ____________

Final Expenses ____________

Support of Spouse or Companion ____________

Extra for Family ____________

Charity ____________

Needs for remainder of life ____________

What Kind Of Coverage Should You have?

What Kind of Coverage Should You Have?

No matter how many different names you have heard given to life insurance products, there are really only three basic kinds:

- **Whole Life**
- **Term**
- **Universal Life**

All those different names you hear on TV and the Internet, etc. are just catchy names for the same things. They almost all fit into one of these categories.

Whole Life Insurance and Universal Life Insurance are both "Permanent Life Insurance" and can be used to fill the "permanent" needs you will establish when you do a proper evaluation.

There Are Only Three Basic Kinds

- Whole Life
- Term Life
- Universal Life

Term Life Insurance is the lowest cost coverage and serves the purpose of covering "temporary" needs. Temporary may be to cover a loan or other debt-related issue for the term of the financial issue, or for the 20 or 30 years that you have the greatest financial responsibility to your family. That's a fairly long time – but it still falls into the "temporary" category as the need dissipates as time goes by. Term Insurance is affordable for most people and the cost of enough coverage to adequately protect your family using permanent coverage would be prohibitive for most of us.

Whole Life Insurance

Whole Life Insurance is permanent insurance coverage where, in most cases, both the premium (what you pay) and the face value (the amount paid out if you die) are guaranteed for life. If you purchased a $50,000 Whole Life Policy and you were paying $75 a month now, you should never have to pay any more than that $75 a month, and you should always have the $50,000 in coverage. Not all Whole Life Policies do guarantee that the premium and/or face value will not change so, if you are considering this policy, you must ask.

Whole Life Coverage

- Combines insurance & savings
- Savings usually interest-bearing
- Provides life-long protection
- Cash Value not (usually) paid with death benefit
- Savings can be accessed by borrowing it - (policy loan)
- Savings can be withdrawn if policy is cancelled

Not very many years ago the consumer had only two basic choices - Term Life Insurance, which offered coverage that increased in price as you got older, and Whole Life Insurance, which offered a level premium for life (most of the time). The argument in favor of Term Insurance was that you could afford all the coverage you need because it was cheap. Those promoting Whole Life favored the idea of still having coverage when you get older. In retrospect, the proper answer has always been the same - most people need some of both - a Permanent Policy that you keep forever, and a Term Policy to look after your larger temporary needs when your family is young. Unfortunately, far too often people have settled for one or the other, still leaving themselves exposed to unnecessary risk. Whole Life Insurance with a guaranteed premium and guaranteed face value would fill the permanent part of your life insurance need, but today there is another option to consider - Universal Life, which we will cover a little further on.

Whole Life Insurance **always** pays out the benefits – eventually, so it is priced accordingly. Unlike Term Insurance, which only pays out “if” you die during the “term”, Whole Life **always** pays out **when** you die – be that prematurely or of old age.

Here are the main characteristics of the most common Whole Life Insurance policies:

FACE VALUE is (usually) guaranteed for life.

PREMIUM is (usually) guaranteed for life.

CASH VALUE that accumulates is usually a combination of a "guaranteed" cash value, interest, and dividends.

The term - **"DIVIDEND"**, in the case of Whole Life, is a refund of excess premium based on the company's mortality rate and some other factors; it is **not** a sharing of profit like a dividend in an investment.

With most of these policies, when an insured person dies, the death benefit is the "greater of" the **FACE VALUE or** the **CASH VALUE**, but not both.

The **CASH VALUE** often may not begin to accumulate until after 2 to 5 years.

The **CASH VALUE** bears interest and therefore the return paid into the policy is similar to the return in a GIC.

The **CASH VALUE**, other than the dividends, cannot be simply withdrawn like it can in a Universal Life policy. The cash value can only be accessed through a **"POLICY LOAN"**, which then becomes a debt against the policy. If it is not paid back, the policy loan plus interest is deducted from the face value on death.

The full **CASH VALUE** can be accessed by cancelling the policy.

Term Life

Term Life Insurance is the simplest kind of insurance you can buy. It is similar to the insurance you buy to insure your home against fire and the kind you would buy on your car. It covers the “risk” and nothing more. There is no “savings component”.

With Term Life you pay a “premium” and if you die, the company pays your beneficiary. If you live out the “term”, they keep your money to pay out on behalf of others who have died and to make a profit. It is priced much lower than any permanent life insurance because most people live beyond the “term” and the company only has to pay out on the policy holders who do die before the ”term” is expired.

Term Life Coverage

- Lowest in cost
- Is “temporary” coverage
- Cost increases as you get older
- Ends age 75 – 85 (or sooner)
- Should be used by most people to cover most large insurance needs

BUT IT WILL RUN OUT

It will run out and therefore you **must** also purchase a permanent policy to cover long- term needs

The most common Term coverages are:

- **5 Year Term**
- **10 Year Term**
- **15 Year Term**
- **20 Year Term**
- **Term To 100**

Most Term Policies are “Renewable” and “Convertible”. Renewable means that as each “term” expires, you can “renew” the policy for another term by paying a new, pre-established price, which is offered in the original policy. To renew, you do not have to qualify or submit health information. Convertible means that you can “convert” the Term policy, in whole or in part, to a “permanent” policy, which the company sells if you do it during the “term” and within a certain age limit. There are some benefits to having these features available in future years.

10 Year Term expires or renews every 10 years, 15 Year Term every 15 years, and so on.

The “Term to 100” is kind of a misnomer because it is actually a “permanent” insurance coverage that, in most cases, is guaranteed not to increase in cost up to age 100 and even then the coverage doesn’t end. It becomes “paid-up” and you no longer have to make premium payments (should you live beyond age 100), but when you die it still pays out the face value. What makes Term 100 different from other permanent policies is that it has no frills. There is no cash value and usually no “paid-up” value until you reach age 100. Because of this, it is priced very reasonably for a “permanent-style” policy, but still more costly than policies with a true “term” like 10 or 20 years.

There are two main situations where you should consider Term Insurance:

When you have young children, this is when most people have their greatest life insurance need. To cover this need with permanent insurance is not usually financially viable for most people. This is the greatest correct application for Term insurance.

Another correct application for this kind of coverage is to cover a debt. Term insurance can be the best way to cover a mortgage, a business loan, or other debt, so if you die prematurely the debt is paid off by the insurance.

The Life Insurance policy you may be offered through a lending institution to cover a mortgage loan or other debt is another “form” of Term Insurance with a “term” more related to the length of the loan than any other factors, and in this case it may serve a good purpose, however, it is always wise to explore such a need with your own life insurance specialist or financial advisor to see if a better product is available for your need. Often, purchasing such coverage directly from the financial institution you are borrowing from can have some disadvantages. Do some comparison shopping before making such a decision. A well-priced Term policy can often cost less than the life coverage sold by the lending institution and may have other very important benefits.

Universal Life Insurance

It must be acknowledged here that Universal Life Insurance is one of the more complicated types of insurance for most people to fully understand. Having said that, other than Term Insurance, it is probably the best insurance product that the industry has ever created. For that reason, if you wish to gain the most benefit from your life insurance (and investment portfolio), it is an absolute must that you have some understanding of this product.

Universal Life is available as a very effective combination of Permanent Life Insurance, a "tax-sheltered" investment program with "investment fund style" investment options, plus great tax advantages when used properly. You can also add your Term insurance needs to the package with cost benefits to you by reducing the administration costs to the company.

Universal Life Coverage

- Cost is guaranteed for life
- Economically priced – like Term to 100
- Becomes "paid-up" at age 100
- Can be paid up earlier

HAS CASH VALUE WHICH.....

- Can be paid as part of the death benefit – tax free
- Is a "separate" investment account inside the policy
- Can be withdrawn by you at any time
- Can be used to pay future premiums
- Has interest-bearing or investment-fund investments
- Grows "tax sheltered"
- May be available tax-free if you're disabled
- May be "leveraged" as tax-free income at retirement

As we explore this product, we are looking to fill two life insurance needs and to learn about one very lucrative investment vehicle. To find a good Universal Life product, you will be looking for:

- Low cost **Permanent Coverage** with a guaranteed premium - to give you, at least, a small amount of coverage that will last for life.
- The possibility of covering your **Term Coverage** in the same policy with a reduced cost because of the reduced administration cost to the company.
- A flexible **"tax sheltered" investment program** with variable investment options. You can save as little as $5 a month in this policy and gain valuable benefits, so it does not have to be for wealth accumulation only, although wealth accumulation with reduced taxes is one of its uses.

A very important fact that most people are unaware of is that the insurance industry has, for many years, enjoyed a unique position in its relationship with the powers that levy taxes. Whether this is because of their enormous collective size, their ability to influence, or other factors, is immaterial. The fact is that you can gain a considerable tax advantage by using insurance products when your strategy is properly applied. The key here is to at least understand enough so that you see that your strategy **is** "properly applied". This product, when purchased with the guaranteed level premium, is a permanent insurance product like Whole Life, but has many additional features that may benefit most consumers.

Look at Universal Life as one policy with two distinct products inside. One is life insurance and the other is an investment. We will first look at the insurance side.

The Insurance "Side" Of Universal Life

There are two choices of insurance inside the policy.

One insurance choice is "One Year Renewable Term". This choice should be considered if your main motivation is to create a fair size tax sheltered investment and the insurance is just a secondary concern. The main decision for people in this category is how much they wish to invest annually and usually not how much insurance do they need.

The more popular option, and the one we will mainly be dealing with, is the **"Guaranteed Level Premium"**, which is similar to Term 100. In some cases it is actually priced lower than Term 100 and therefore makes Term 100 pretty well obsolete. For most people, (those who are using this policy to get low cost permanent coverage) the Guaranteed Level Premium option is the best choice. The "minimum premium" is guaranteed for life and will not increase so you will never have to be concerned about the cost going up or it "running out of money", which is something that can happen with the other option. In the worst case scenario, the policy becomes "paid-up" at age 100. In other words, like Term 100, if you happen to make it to age 100, the coverage stays in force but you don't pay any more. When used properly, these policies will usually be paid- up long before you reach age 100, as you will see.

Here's how they work. The policy is offered with a "minimum" and a "maximum" premium. You need only pay the minimum premium to maintain the coverage and **that is guaranteed**. A "maximum" premium is calculated by the company using present tax guidelines. If you put in more than what is permitted under these tax rules, the extra will be placed into a "holding" account where only that portion is not tax exempt. By this maneuver, the company always protects the "tax exempt" status of your policy without you having to worry about it. Of course, there is usually enough extra room to satisfy most people's needs and if there is not, you can increase the maximum by increasing the amount of insurance coverage.

Let's say you have a policy where the minimum premium is $80 and you choose to deposit $110 to feed the investment. Most of the $80 is taken to pay for the insurance coverage. A small amount from the minimum premium does end up in the investment and, depending on which company you are dealing with, all or most of the "extra" $30 should end up in the investment as well. Now, a word of caution - there can be a vast difference from company to company in something called "surrender fees", which can affect your investment, and in particular can affect your access to your savings for the first 5 to 10 years. So, read the section on "surrender fees" carefully. The "structure" of the policy offered can render some policies more suited to some people and other policies more suited to others. Here again is the reason to deal with a good life insurance specialist or financial advisor as most can offer all types of coverage and should be committed to helping you identify which one is best for your needs.

THE INVESTMENT "SIDE" OF UNIVERSAL LIFE

If you choose the company and the policy properly, there will be a "pool of money" building up inside your policy in the investment side as soon as you deposit premium dollars over and above the minimum premium. In a moment we will be covering how this money should be invested, but let's just focus on the "pool" itself. How can you access this money if you want to, and what can it be used for?

As long as it is not tied up due to high surrender fees, this is your money and you can withdraw it anytime you want. Most companies do charge a "withdrawal fee" of around $25, so it is not intended to be used like a bank account. A more appropriate use is that this money can be used to pay future premiums. If you get in financial difficulties and can't make your premium payments, you can instruct the company to take the payments from your cash value. Indeed, if you have a premium pre-authorized payment returned from your bank unpaid putting your policy in arrears, the company will automatically go to your "pool of savings" for the premium payment and keep doing that until it runs out if necessary. Now, this is a good thing. It can keep your valuable coverage alive during hard times or just allow you to take a "premium holiday" if you wish sometime down the road. Also, as the investment balance grows, at some point in time, it can have a large enough value that the "interest" on that balance can be sufficient to pay the "cost of insurance" and you can stop paying for the rest of your life. As you can see, there are no real negatives in this program, as long as you find the right company, and there are lots of positive features and benefits.

INVESTMENT FUND STYLE INVESTMENTS: As well as the separation of insurance and savings, most UL (Universal Life) policies offer a variety of good investment choices suited to the risk tolerance of the individual. In other words, you can invest in guaranteed investments similar to GIC's, in diversified investment products, or in pure equity investments or equity "substitutes" like Index Funds.

SAVINGS ARE HELD SEPARATE: Unlike "savings type" life insurance products of the past, the investment portion of Universal Life is treated quite separate from the insurance side. It is really like a GIC or Mutual Fund with a "tax protected" coating that the tax department can't penetrate. When used as part of your overall investment strategy, Universal Life is a powerful vehicle.

NO FOREIGN CONTENT RESTRICTIONS: There are no foreign content restrictions. (Since the February 2005 Federal Budget, foreign content restrictions were removed from RRSPs as well, so UL is no longer an advantage over RRSPs in this factor, but this may still be useful information if such restrictions are ever reinstated on RRSP investing).

TAX SHELTERED: As long as you don't exceed the maximum allowed in the policy, all the funds are going to grow "tax sheltered". Although they are not "tax deductible", you will not have to claim the interest as income each year as you earn it. More on the long term tax consequences of this is presented further on in this publication.

SURRENDER ACCOUNT IS AVAILABLE TO YOU: As mentioned, any funds in the "surrender account" can be withdrawn by you whenever you wish and for any purpose. They can also be used to pay future premiums. This money is withdrawn like most other investments; you do not have to take out a "policy loan" like you would have with older style life insurance products.

TAX CONSEQUENCES: As pointed out, the policy keeps your savings "tax sheltered" as they grow. However, at some point in time, you will probably want to access this money. If you just withdraw it in large amounts, there is going to be a tax liability. A large percentage of it is going to be treated as income and will trigger taxes similar to withdrawing funds from an RRSP. See the section ahead – "Getting Your 'Savings' Out Of Your Universal Life Policy" for more on this subject.

MAKING INVESTMENT CHOICES IN UNIVERSAL LIFE

A good UL policy is going to offer you a variety of investment choices. Among those choices should be some "aggressive" investing options. The investment choice you make should be in line with your risk tolerance and your long term expectations. Everybody says they want the highest returns possible. To achieve this, you may have to adjust your risk tolerance. Your risk tolerance will usually go up quite dramatically as you learn more about the true principles of good investing. It is ignorance that breeds fear. There are a number of different approaches to successful investing.

Most companies are going to give you the choice of GIC style investments and mutual fund style investments. Give serious consideration to investing in funds with good potential and listen to the advice of your advisor. In the current environment of financial uncertainty, most people go with a well-balanced "asset allocation" or "balanced fund" approach to achieve reasonable returns with acceptable peace of mind. These investment choices can be changed throughout the life of the policy, and should be reviewed every few years relative to the world economic environment and altered accordingly – like any investment vehicle, unless you have chosen one of the relatively newer options that many companies have included in their "options" where the company does the alterations for you using an "asset allocation" style of fund.

GETTING YOUR "SAVINGS" OUT OF YOUR UNIVERSAL LIFE POLICY

There are three ways of accessing your money in a Universal Life Policy without paying normal income tax on the earnings. These features are the reason that so many wealthy people use this strategy as an investment vehicle for their own future use, or to pass on their money to their heirs.

DEATH BENEFIT: If you leave the investment in the policy until you die, it becomes part of the death benefit as long as it is so stated on the application or in the policy. As there is some variation from company to company on this issue, be sure to ask your financial advisor when you purchase this product if it is set up so that the accumulation fund forms part of the death benefit on your death. Confirm this fact when you receive your policy; it is very important.

DISABILITY: If you become disabled, you may be able to withdraw part or all the savings from your policy without any tax liability. Again, there is a difference from company to company. With some, you must become disabled before age 60 or 65, and with others, under certain circumstances, there is no age limit. No one is looking forward to becoming disabled so they can access this money; it's just an extra feature. The next one is the one you will look forward to using.

LEVERAGING: Here is the method that most people plan on using. If you are sheltering this money with the intent of using it someday for yourself, as opposed to leaving it behind when you die, you will want to understand this strategy. As we explore this "leveraging" method, remember that a "death benefit" is not viewed as income and is not taxable. That includes the accumulation fund when it becomes part of the death benefit as long as it is done properly. When you have accumulated a substantial balance in your UL investment account, it can be used as collateral to borrow money. Let's suppose you have a UL policy with $300,000 in the surrender account. You take your statement into a bank and apply for a loan using this as collateral. Providing, of course, that you have good credit, the bank will lend you up to 90% of the value of the fund. If you qualify for the full 90%, you would walk away with $270,000. You would ask the bank to "capitalize" the loan. This means there are no payments of principle or interest. The loan will be paid, including accumulated interest, when you die - from the DEATH BENEFIT. The death benefit is not taxable. Any funds over and above what you owe the bank will go to your designated beneficiary. As the interest is accumulating on your loan, so also is the interest still accumulating in your policy, hopefully faster than the loan. You just acquired $270,000 and it has not drawn a penny of tax; you don't pay tax on borrowed money.

Now in practice, most people will probably not want to access a large amount of money like that all at once. Instead of taking this money as a lump sum, you might prefer to have a "line of credit" from the bank which will allow you to withdraw the money as you wish. This "leveraging" strategy is a little more complex than other ways of accessing your savings, and should be discussed with your life specialist or financial advisor.

Surrender Fees And Other Charges In Universal Life

One of the main objections that some financial commentators have to using UL as an investment vehicle is the "surrender fee". I believe that a word of caution is appropriate here. The surrender fee is an amount kept by the company from your cash value if you cancel your policy in the first 5 to 10 years.

Some companies have a surrender fee that is levied only on the minimum premium. In other words, if you put in extra money to feed the investment, and cancel it early or want to withdraw it, most of your money is there and available to withdraw.

Other companies, and this is where you have to be diligent, have surrender fees for the first ten years where, if you cancel your policy, they keep most of or all your savings. We agree with those who criticize this negative element. A small surrender fee is acceptable, but these large fees are not a good element for **most** consumers. The reason given for the large fees is that, according to the tax regulations, the policies with the larger fees allow larger amounts of money to be tax sheltered inside the policy than do the policies with the lower fees. So, they are somewhat justified - **if you are wealthy** and your main goal is to tax shelter money, and there is no chance that you are going to cancel the policy until the surrender fees are dissolved - usually 10 years into the policy.

The main point here is that **unless you are wealthy** and because you are wealthy the main reason you are buying a Universal Life Policy is to tax-shelter some of your wealth – make sure the policy you buy has the low surrender fee structure.

In other words (because we want to be clear here) if you are buying a UL for the insurance benefits and you might put very little, or a moderate amount of savings into it – then it is still **a very good product** as long as it only has the small surrender fee structure. Ask your advisor to make sure this is clear before your purchase.

Insurance companies, like all other businesses, exist to earn a profit. Reasonable charges for the administration of these policies are to be expected. There are fees for certain administrative charges, and management fees for caring for your investment. However, other than the surrender fees, they are not of much consequence and are not in need of discussion. One company might point out that they have lower charges for one service and yet, may be less successful in getting the best return on investment for you. Trying to evaluate all these things would be more cumbersome than it would be worth.

RIDERS AVAILABLE IN UNIVERSAL LIFE

As in pretty well all life insurance policies, most companies offer a variety of **"riders"** that you can purchase as additional benefits to your UL policy. Similar riders are available in some other types of policies as well – particularly in Whole Life.

Here are the ones that would be of interest to most people.

TERM RIDER (OR COMPONENT): This is the most important rider to understand. As you will see as you put together all the advice this book covers, we are recommending that you purchase both **permanent** and **temporary** coverage in most cases. You can acquire these two coverages by purchasing a small level premium UL policy and purchasing a separate Term policy from the same or another company if it is financially advantageous to do so. However, every life insurance policy has a charge called a "policy fee". If you can cover all your needs in one policy, it can often reduce the overall cost. When you look at the Universal Life policy, be sure to get a quote on filling your Term needs with a Term Rider or "Term component" inside the UL policy.

ACCIDENTAL DEATH (AD): With this rider, you can add an additional amount of life coverage, which will pay if you die accidentally. Be careful that you understand this coverage. There are a number of points that most people don't understand in AD. As an example, if you were hurt in an accident and lived for more than six months, and then died as a result of you injuries, many of these policies would not pay. This is also the case in many of the AD policies that are sold through credit card companies. AD is worth considering especially if you work in an occupation that is risky, or live a lifestyle that may expose you to higher than normal risk.

ACCIDENTAL DEATH AND DISMEMBERMENT (ADD): This is the same coverage as above with the added benefit that if you lose the use of certain extremities or sight, you would receive a payment yourself.

WAIVER OF PREMIUM (WP): With this rider, if you become disabled, the company will pay your future premiums for you. This can keep the policy in force if you ever lose your income due to a disability.

CHILDREN'S RIDER (CR): You can add insurance on your children for a very a reasonable premium. They would remain covered until they reach a certain age, usually 25.

GUARANTEED INSURABILITY (GI): For an extra premium, the company will guarantee to sell you additional coverage at a future time. The opportunities for this purchase carry certain restrictions. If you cover your needs properly with Term coverage, you should not need this rider.

SUMMARY

Now, let's try to bring all this information together and put it in simple terms.

- Most people will experience an evolution in life insurance needs. A small need when younger with no dependents, jumping greatly when they have dependents, and reducing again as their dependents go out on their own.

- Consider covering your needs for your entire life while you are younger and healthy. You don't want to end up as a senior with less savings than you planned for and with, no life insurance.

- Consider covering your permanent needs with a Level Premium Universal Life Policy and your temporary needs with a 10, 15 or 20 Year Term Policy.

- If it is to your benefit financially, cover your Term needs inside the Universal Life Policy.

- At the very least, if it's all you can afford, protect your family by purchasing sufficient Term coverage to support them if you should die prematurely.

A Final Comment

On the subject of life insurance, the consumer is faced with more confusing choices than ever before. You can buy it over the Internet, through the mail, or over the phone. You might think that one of these choices is better than sitting down with a financial advisor in his or her office, or in the comfort of your own home. In this, we strongly advise caution.

For the most part, we believe your needs can be better filled by consulting a good, well trained financial advisor or life insurance specialist who has your best interest in mind. Today, financial advisors are better qualified than ever before to help you identify your needs, and find you the best products. There is no advantage to buying over the Internet, through the mail, and certainly not from a telemarketer unless you live in a very remote area and there are no qualified advisors to help you.

Someday, you may need the personal advice of a seasoned specialist who knows you personally, and will still be there and willing to serve you when you really need it. There are many good advisors who are still willing to come to your home or visit with you in their office at your convenience, and help you acquire what you really need. If you really think about it, life insurance and financial advice is one of the few services left where you can actually access a real human being who is educated, skilled, and willing to sit down with you face-to-face and help you resolve some of the most important financial product needs you will ever tackle in your entire life. Find a good life insurance specialist or financial advisor and build a relationship and you will be glad you did. In this day and age, they are as important as a lawyer or an accountant, and most of them will help you without any fee structure for their time (unlike a lawyer or accountant). It really is a very good arrangement for the consumer.

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Shopping for Life Insurance

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