Life Insurance

IS TERM LIFE ALWAYS ENOUGH?

Most families are better off buying cheap, straightforward term insurance, but there are situations where universal or whole life policies make sense **By Dan Bortolotti**

If someone you care about depends on your salary, then life insurance is not an option: it's essential. If you die prematurely without the proper coverage, your spouse and kids may be left without any means to pay the mortgage or buy groceries.

But what kind should you get? The most popular is term life: you pay a fixed premium that covers you for a specific period, usually 10 or 20 years. The other major category is called permanent life insurance, because the coverage continues for life. Within the permanent insurance category there are two types: whole life and universal life (see "Whole vs. universal life" below). Permanent policies typically have an investment component as well as the insurance, and a "cash surrender value" if you cancel them.

The usual advice from the financial media is that you should only buy term, because it's simple, transparent, and cheap. Permanent insurance is none of those things. The premiums for universal and whole life policies are often five times higher than those of a 20-year term policy. To give a rough example, a 35-year-old male non-smoker might pay $35 a month for a term policy with a death benefit of $500,000. A universal life policy with the same death benefit might cost $190 a month, while a comparable whole life policy could easily top $250.

Because such policies are expensive, they've developed a bad reputation. Anyone in the insurance business will tell you that whole life and universal life policies are widely loathed by the general public. "Be prepared to get beaten up for suggesting anything other than term," says Glenn Cooke, an independent broker who operates Insurecan.ca and uses term policies for more than 90% of his clients. "Permanent insurance may be more appropriate in certain cases, but whenever I mention it, people get upset. Anyone who has done a little bit of reading gets aggressive."

There are legitimate reasons for being skeptical: whole life and universal life policies have a long history of being oversold by pushy salespeople motivated by higher commissions. That's left some families paying for the wrong benefits. Geoff Graham, president of Graham Financial Strategies Group in Niagara-on-the-Lake, Ont., stresses that a family's first concern when buying insurance is to make sure the death benefit is large enough. Any investment or cash value component is secondary. "I've seen people who got the deluxe plan with all of these features, but if they die, their spouse and children are going to be in trouble."

When Myron and Anne Janzen went looking for insurance, their goal was to protect their three children, not to build an investment. "I was looking to get coverage for 10 times my annual income," says Myron. The Janzens, who live in Winkler, Man., also wanted coverage for Anne, who works from home. So they chose a joint term policy that will pay $500,000 if either was to die. The cost is just $49 per month. "When I looked at the premiums for term versus whole life, I knew I would be much better off taking the difference and investing it myself."

Does that mean you should avoid whole and universal life under any circumstances? Turns out the answer is no. A simple term policy is adequate for the vast majority of Canadians, especially young parents who need a hefty death benefit they can afford (see "How to buy term" on the facing page). But there are several situations where permanent insurance really is the better choice.

You want to leave a legacy

Say you have a disabled child and you want to leave her $500,000, no matter how old she is when you die. In this case, it makes more sense to buy a permanent insurance policy than to try to save that yourself. The least expensive way is with an "unfunded" universal life policy, which means you pay only for the insurance and never add money to the investment component. A similar product called "term to 100" also provides coverage for life, but with no investments and no cash surrender value.

Asher Tward, vice-president of estate planning at TriDelta Financial in Toronto, explains that the median life expectancy for a healthy 35-year-old male is about 44 years. If you pay a premium of $190 per month for 44 years and your heir receives a half-million-dollar payout, that works out to an annual after-tax return of about 6%—more than most people would be able to get by investing on their own. "You also went to sleep every night of your life knowing that you had $500,000 of protection," Tward says.

You could become uninsurable

If whole life and universal life policies are controversial for young parents, try recommending them for kids. Despite what your agent or broker says, in cold financial terms children are a liability, not an asset that needs to be protected: no one depends on young children for their income. But there is one situation where a permanent policy for a child makes sense.

WHOLE VS. UNIVERSAL LIFE

With whole life insurance, you typically pay a level monthly premium, part of which goes into an investment account that grows every year—but you have no control over the details. Universal life policies have more flexibility (but also more complexity) when it comes to the premiums and the investments. Both types have a cash surrender value if you cancel, but individual policies vary widely, so read the fine print.

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PUTTING SAFETY FIRST
The Janzens' top priority is making sure their kids are protected from risk

Photograph by Thomas Fricke

Just ask Christina Huppé, a 33-year-old mother in Kanata, Ont. She and her husband Marty purchased whole life coverage for nine-year-old Hanna and three-year-old Sébastien. "I know this is a touchy subject for some parents: they think it's morbid to insure their children," says Christina. "But in our case, I have a genetic blood disorder, and my children have a 50% chance of inheriting it." If her children do inherit the disorder, they'll find it difficult or impossible to get affordable coverage as adults. "So we decided to give the children an insurance policy now to protect them and their families for the future. We're looking ahead a couple of generations."

You have more than you'll need

"Whenever I recommend that people use whole life, it's never because they need more insurance," says Warren MacKenzie of Weigh House Investor Services in Toronto. "It's because they've got more money than they will need, and they're paying tax on it."

The crucial point here is that using a permanent insurance policy as a tax shelter makes sense only when your RRSPs and TFSAs are maxed out, you have a significant amount invested in bonds or other fully taxable investments, and you are virtually certain you won't need the money in your lifetime.

Anil Yaser has found himself in just that predicament. A physician in Toronto, Yaser (not his real name) has amassed enough money to retire today at age 50. Even though he's single and has no children, he's considering buying permanent life insurance to shelter some of his wealth from taxes.

Yaser has a lot of money in bonds, and he's losing almost half the interest payments to taxes. If he uses that money to fund a whole life insurance policy with an investment component, he can shelter it while he's alive. Then it will transfer to his nieces and nephews tax-free when he dies.

Critics of whole life point out that you have no control over how the money in your policy is invested. But MacKenzie argues this feature is often a benefit in disguise, since most people do a poor job of managing their own investments.

Your estate will face very high taxes

If you die at a ripe old age, you're not likely to have dependents who are still relying on your income. But that doesn't mean your family won't face big expenses when you pass on and your estate is divided up. If you own property, for example, you can't pass it to your children tax-free: your estate will be on the hook for capital gains taxes, whether or not your heirs sell the real estate.

If your partner is already gone, the final tax bill on your investments can also be enormous. When the second spouse dies, RRSP and RRIF investments are fully taxable in the year of death. Depending on your province, that means 39% to 46% of your nest egg will go to the government instead of your children, grandchildren or charity. "Some people say they don't care about these taxes because they'll be dead," Tward says. "Others realize they can put aside some money every year and make their estate whole."

As part of a comprehensive estate plan, you might consider a permanent life policy with a death benefit designed to offset all or part of your final expenses. The premiums can be very high if you don't get the coverage until late in life, but the payout is guaranteed. If you know you won't need the cash while you're alive, it may be the best way to keep your wealth in the family.

HOW TO BUY TERM

If you've decided on term insurance, ConsumerTerm.com is great place to get started. At the website, you'll find an online calculator to help you estimate how much insurance you need. You can then enter your personal details to get quotes from several insurance providers at once. Armed with this information, you can consult an independent broker to get the right policy for your needs.