Bulletin

RBC Dominion Securities

Permanent Insurance: An Economical Approach to Risk Management

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Life and living benefits insurance products are priced based on (among other things) your age, health, family medical history, vocation, and in some cases the activities you participate in - such as skydiving, motor racing, scuba diving, or flying. This is true whether you're considering term or permanent life and living benefits insurance.

We often associate the low cost of term insurance as efficient for covering a variety of short term needs such as income replacement if a spouse or loved one dies prematurely, as a means to cover off debts or other obligations, or as a method business owners use to fulfill a buy-sell agreement. It's a true statement; however, we do this at the expense of considering future needs and insurability. As a result we may overlook long term planning and some basic principles that can make purchasing insurance a flexible long term asset.

While there is no denying the truth of the above statements, permanent insurance can provide the same necessary coverage today and create future planning opportunities at an affordable cost.

The Basics of Term Insurance

Term insurance policies generally carry the rights to renew and convert the term insurance coverage. The renewal gives the right to continue the term insurance contract at increasing rates at set intervals to a future expiry date. The conversion gives the owner the right to convert to permanent insurance, without future medical or financial evidence.

Below outlines the increasing interval cost of a $1,000,000 term insurance product for a 45 year old male to age 80.

Age	Annual Cost	Present Value of Aggregate Cost
45 – 54	$ 1,170	$ 10,496
55 – 64	$ 7,357	$ 62,054
65 – 74	$ 20,850	$ 176,201
75 – 79	$ 51,024	$ 292,037

A present value calculation or "discounting" converts future dollars into current value equivalents using a discount rate. This calculation takes into account the time value of money (how a dollar spent today is worth more than a dollar spent in the future). The Present Value of Aggregate Costs is the present value of all premiums to the end of that time period.

Source: LifeGuide April 2010, Manulife Financial - coverage ends at age 80. Present value discount rate of 2.5%

Another Consideration for Converting Term Insurance

Planning for a future risk is not the only consideration for converting term insurance. Occasionally it's a prudent and necessary planning option. Individuals who have term coverage who have suffered an illness or injury, or who have somehow become uninsurable (they would not qualify for new insurance) still have options. They generally consider conversion to permanent insurance to secure insurance coverage at the lowest long term cost while they still have term insurance coverage. These individuals may never receive an offer for new insurance so the conversion allows them to continue coverage and take advantage of some of the unique features permanent insurance offers.

Preparing for Future Needs Today

In the future, as needs and risks change, the concerns for short term needs may be replaced by retirement income planning, wealth protection, or charitable giving. In addition, for business owners this could mean that the coverage for their buy-sell agreement is no longer required but they may have a need for succession planning or freeing trapped surplus.

There are a few options in preparing for this transition. If you have term insurance with conversion privileges you can convert to a permanent product with costs based on your age at that time (future age) without providing medical or underwriting evidence. The other option would be to have applied for permanent insurance from the onset to cover today's needs and to prepare for future needs.

For example, a 45 year old male wants to provide his family with income to his age 65 to facilitate income replacement if he died from at any point before age 65. At 65 he knows that he won't need the coverage for income replacement but wants to keep the coverage amount and use it as a means of wealth transfer or for paying a future tax liability. He purchases a term insurance product today with a $1 million death benefit (as above) with renewal and convertible features. When he's 65 he converts it to permanent coverage and pays 65 year old rates from that point on ($28,930 per year). He's been able to protect both his short term and long term risks.

If, however he bought permanent insurance today (at age 45) the cost would be $6,980 per year – and while higher than the initial ten year term, the cost is 74% less than the future cost of the same coverage. Here's what the opportunities look like side by side:

	Convert Term to Permanent @ 65		Permanent		Difference
Age	Annual Cost	Present Value of Aggregate Cost	Annual Cost	Present Value of Aggregate Cost	(Permanent – Conversion)
45 – 54	$ 1,170	$ 10,496	$ 6,980	$ 62,617	$ 52,121
55 – 64	$ 7,357	$ 62,054	$ 6,980	$ 111,533	$ 49,479
65 – 74	$ 28,930	$ 220,436	$ 6,980	$ 149,746	- $ 70,690
75 – 84	$ 28,930	$ 334,163	$ 6,980	$ 179,598	- $ 164,566
85 – 90	$ 28,930	$ 395,471	$ 6,980	$ 191,977	- $ 203,494

Source: LifeGuide April 2010, Manulife Financial - coverage ends at age 100. Present value discount rate of 2.5%. Assumed life expectancy is age 90.

If coverage continues to an assumed life expectancy of age 90, then the individual would have been financially better off purchasing the permanent coverage today. It would have saved

$204,000 in today's dollars over term insurance and a conversion. Sometimes the perceived high price tag of permanent insurance can be monetarily efficient over the long term.

Permanent Life Insurance

Permanent life insurance products offer guaranteed costs that are payable for life or for a limited period of time. Some offer guaranteed cash surrender values and you can chose a payment period that suits your budget and needs. In addition, some contracts participate in policy dividends and other offer mutual fund type and guaranteed interest investment options. Permanent protection can meet your long term insurance needs, plus give you the opportunity for tax-deferred growth in savings.

Tax-Exempt Insurance

The insurance industry recognizes that the need to utilize tax-exempt investing is appealing to individuals who pay tax on growth from their investments and to individuals and businesses with surplus capital. To that end, the industry has created strategies and products that effectively position insurance as a tax-exempt investment to complement your existing portfolio. A policyholder can reallocate a portion of their fixed-income investments into a tax-exempt policy therefore effectively eliminating future taxation from that portion. The net amount less the insurance costs will accumulate tax-exempt therefore generating no tax slips. Products have become sophisticated to the extent that the actual ongoing cost of managing the tax-exempt portfolio may be comparable to that of a plan that is tax-exposed.

Funds can be either left on account and paid out as part of the death benefit for the next generation or accessed for tax-free income via a loan strategy. However, in either case, a tax-free death benefit flows to the estate or directly to a named beneficiary. The estate can then utilize the proceeds to fund for capital gains and/or income tax liabilities, create a personal legacy for children or other dependents, or provide a social legacy for charities, trusts or foundations.

Summary

There are a number of insurance solutions available to satisfy your wealth management objectives. Choosing the right products and solutions is paramount to meeting your short term and long term objectives. In addition to choosing efficient ways to fund your coverage there are a variety of solutions that can provide tax-exempt growth opportunities. Planning and preparation for your future risks and insurance needs today can pay dividends in the future.