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Why the wealthy invest in life insurance

Here are four common reasons, for not just the well-to-do but for many, to include buying life insurance as part of your planning

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If most people knew that they could buy life insurance and have it paid out during their lifetime, they probably would buy more of it. Now, as it stands, you have to pass away for that big death benefit to pay out – although some have tried to collect early.

Consider the story of Ronald Wayne Blankenship who, in 2006, ran for the office of sheriff in Jefferson County, Ala. During his campaign, Mr. Blankenship was accused of faking his own death a few years earlier so that his wife could collect life insurance proceeds. Mr. Blankenship denied the accusation and said it just was a coincidence that the fraudster in question shared the same name as him, same birth date, had a wife with the same name, carried on the same profession (a shoe repairman), and looked like him. Collecting life insurance early is no easy task.

Even though life insurance won't be paid out until you're gone, many of the most affluent individuals in Canada – and around the world – see life insurance as an important part of their planning. This is true even when insurance isn't needed to provide for the needs of a loved one. Why, then, are these folks buying life insurance? Here are the four most common reasons – and they can apply to many, not just the well-to-do.

To enhance investment returns

An important characteristic of life insurance is that investments inside the policy grow on a tax-sheltered basis, which can improve investment returns, particularly where the costs of managing those dollars inside the policy are reasonable. With many whole-life policies, the fees charged by the insurance company to manage the portfolio of investments is low, and the returns have been quite good relative to the risk. Finally, some affluent Canadians borrow to pay their life insurance premiums even when they don't have to. Why? Because the cost of borrowing is low today, and the returns inside the policies have been stable. Since these folks aren't putting up much of their own money when buying the policy, the cash-on-cash return is very high when the death benefit eventually pays out. Borrowing is not for everyone – but it can make sense in certain cases.

To equalize an estate

Some assets may be better left to a certain heir, or heirs, rather than being shared by all of them. A business is a prime example. But if you're going to leave specific assets of value to particular individuals, what will your other heirs inherit? Some people think it's important to leave heirs with assets of approximately the same value. Life insurance can be a great equalizer. If, for example, you leave the cottage worth \$800,000 to one child, and have \$300,000 of investments to leave to another, you could buy life insurance of \$500,000 to top up the inheritance for the second child so that both inherit equal value. Don't forget to consider how taxes will affect the amounts inherited by each of your heirs.

To donate to charity

Some individuals have the means to make very large gifts to charity today. But if you're like most, you may be able to make an even larger gift to charity by investing in a life insurance policy to fund a gift upon your death. You can do this in different ways. You could have the charity purchase a policy on your life while you donate the cash annually to pay the premiums (you'll receive a donation tax credit for the cash donated for the premiums). Or, you could donate an existing policy to the charity today and continue to pay the premiums on behalf of the charity (there could be a taxable event when transferring the policy, but you'll receive a donation tax credit for the fair market value of the policy today, which is generally the cash value of the policy; plus, you'll get a donation receipt for the value of the premiums you pay each year). My preferred idea, however, is to invest in a policy that you continue to own and name the charity as the beneficiary (you could name your estate as the beneficiary and leave instructions in your will to donate the proceeds to charity, but this last idea will give rise to probate fees in most provinces).

To cover taxes on death

If you have illiquid assets that will give rise to taxes on death, such as a business, or real estate, give thought to buying life insurance to cover those taxes so that your estate doesn't run into a shortage of cash when you pass away.

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