Wealth Management

Is insurance the missing piece in your wealth-transfer puzzle?

“Many aren’t aware of the leverage life insurance can provide.”

We often worry not only about building and protecting wealth in our lifetime, but also maintaining those assets for future generations.

Many are turning to life insurance as a way to grow and maximize their wealth as part of a broader financial and estate plan, to ensure loved ones and beneficiaries are looked after when they die.

“Some people see insurance as an expense. They just look at the premium,” says Daniel Duchesne, Vice President and Estate Planning Specialist at RBC Wealth Management Financial Services Inc. “But as soon as we put everything into perspective — that we’re using life insurance as a tax-effective way to transfer money to the next generation or a charity, and because of the return it can provide — they realize why we are doing it.”

Even high-net-worth families who may not need the financial protection of life insurance might use it to enhance the value of their estate.

“Most of the wealthy families that I deal with, because they’re wealthy, they assume they don’t need life insurance,” says Duchesne. “They may not need it, but many aren’t aware of the leverage life insurance can provide.”

How to use life insurance in estate planning

The primary benefit of life insurance is it can provide income for beneficiaries when a policyholder passes away, whether it’s family or a charity, or both.

“If a client wants to transfer a portion of their estate not used in retirement to the next generation — whether that is kids, grandkids or a charitable foundation — insurance is one of the best ways to achieve that,” says Duchesne.

The policy death benefit will typically bypass the estate, which means that the monies aren’t subject to probate (where provincially applicable) and can go directly to beneficiaries without delay.

Life insurance can also help to preserve the value of an estate by leaving money behind to pay for taxes, fees or other financial obligations. This may help to ensure any non-liquid assets, such as a cottage or business, can be left to beneficiaries fully intact and don’t have to be sold. Life insurance policies may be owned personally or held in a corporation or a trust.

The two main types of permanent life insurance regularly used in estate planning are universal life and whole life. Universal life insurance offers investment choices that are self-directed and offer more flexible management to match your investor profile. It's usually suited to individuals who are comfortable managing their own investments. Whole life insurance policies are more suitable for those that wish to have a passive approach to investing, as the funds are managed by the insurance company. It's best suited to those who don't necessarily want to control their investments and prefer more stable, balanced returns.

'Different tax characteristics'

Both types of insurance allow for cash accumulation on a tax-exempt basis. This happens as a result of guarantees within a policy and/or when a policyholder voluntarily deposits more than the basic cost of the coverage. These excess cash flows are invested within the structure of the plan. The money is not taxed annually (within limits) as it grows, and there's no tax payable by the beneficiaries when the policyholder dies.

"The use of permanent life insurance — whether it's a universal or whole life policy — can be a wise investment option, in particular for wealthy clients," Duchesne says. "It's a way for people to produce a new asset class within their portfolio with a different tax characteristic."

The tax efficiency is also why life insurance investments have the potential to generate a higher rate of return than what might otherwise be earned through regular investing, he says. With universal life insurance, deposits can be increased to raise the amount of tax-deferred savings, with some limitations.

An individual's health status matters as they must medically and financially qualify for insurance products.

Overall, Duchesne says the type and amount of insurance a person should buy will depend on their investment risk tolerance, how much money they need to remain liquid in their portfolio and what portion of their estate they want to leave to beneficiaries.

As with all insurance products used for estate planning, Duchesne says investors need to do a thorough cost-benefit analysis to determine what strategy works in their personal circumstances.

'Part of a good financial plan'

"While there are a number of good reasons to consider having life insurance in an estate plan, and different options available, many Canadian families across asset classes remain underinsured," says John W. Hamilton, Vice President and National Manager, Insurance Services at RBC Wealth Management Financial Services Inc.

He believes insurance is often misunderstood. "In many consumers' minds insurance is a negative word," Hamilton says, because it's connected with unfortunate events such as an accident, natural disaster, fire or death.

"In reality, insurance is just part of a good financial and estate plan," Hamilton says.

It provides financial protection and investment advantages that give investors peace of mind that their estate is being looked after.

"You need a plan," Hamilton says. "You need to incorporate protection items because the plan doesn't always come to fruition the way you dreamed it. Life gets in the way."

With wealth transfer, Hamilton says life insurance is an effective way to protect and share wealth — and to leave a legacy on your own terms.

"It's money you can't take with you and want to share with the people you love or the organizations you love, such as philanthropy and community," Hamilton says. "With wealth transfer, you want it to be efficient and to have some certainty that the money goes where you want it to go and do what you want it to do. That's where insurance can play a key role."

For more information, please contact us.