Insurance Considerations for Individuals

Unforeseen events, such as illness, disability or death, can have a devastating impact on a family and their financial future. Insurance is an important part of a comprehensive wealth management plan, and helps provide financial protection against the unexpected. This article discusses several types of insurance coverage available to help individuals safeguard themselves, their family and their wealth.

Life insurance

People buy life insurance such that, upon their death, their loved ones will be taken care of financially. There are two types of life insurance policies: term and permanent.

i. Term insurance

Term insurance provides a tax-free, lump sum payment to the named beneficiary(ies) of the policy, if death occurs within the policy's term. Term insurance can provide coverage for temporary needs such as funeral expenses, to settle outstanding debts, including mortgages, and to help replace the income of the deceased to cover living expenses. For a widowed parent, life insurance can help to cover the costs of raising children, pay university/college tuition fees, or even provide enough financial resources to be a stay-at-home parent. Insurance coverage expires at the end of the policy's term (e.g., five, 10, 20 or 30 years), unless the policy is renewed.

Term insurance premiums are generally lower than those for permanent policies in the early years, which allows for the purchase of higher levels of coverage at a younger age, when the protection needs of a family are often the greatest. However, when an existing policy is renewed for an additional term, the premiums can be substantially higher than premiums on the previous policy. Many term policies can also be converted to permanent coverage within a specified timeframe, generally before the age of 65.

ii. Permanent insurance

Permanent insurance, such as whole life and universal life, provides coverage for long-term needs that are ongoing, evolving and of a permanent nature, such as estate preservation, business succession planning, supplementing retirement income, income tax reduction, and paying one's final taxes and estate settlement costs. These policies provide lifetime insurance protection, as long as the premiums are paid.

Permanent life insurance includes a life insurance component and may also include an investment component. Premiums for permanent life insurance are higher initially than for term insurance, but generally remain level so premiums don't increase with age or as your health status changes.

Some permanent life insurance policies accumulate a cash value that is either added to the face value of the policy and paid out upon death, or returned to the policyholder if the policy is cancelled.

The two main types of permanent insurance are whole life and universal life.

Whole life insurance – Whole life insurance is a type of permanent life insurance that guarantees the amount of your premiums; these premiums will not change as you get older. The insurance company oversees the investment component of the policy and will generally invest in fixed income type securities. These policies often have a guaranteed minimum cash value, and the death benefit, an amount paid out upon death, is also guaranteed.

Universal life insurance – Universal life insurance combines life insurance with an investment account. Universal life insurance is generally suitable for individuals who have a permanent need for life insurance, have maximized their annual Registered Retirement Savings Plans ("RRSP") and Tax-Free Savings Account ("TFSA") contributions, and are seeking additional tax-sheltered cash accumulation. Universal life premiums can be increased or decreased, within limits specified in the policy, providing flexibility for sheltering additional deposits.

The policyholder is also responsible for selecting how the premiums are invested. As a result, the death benefit and cash value of the investment account may increase or decrease depending on the types of investments chosen and the returns on those investments. Policyholders can usually borrow against their policy, using the policy's cash value as collateral.

Upon death of the policyholder, the death benefit, which would include the investment component, is paid tax-free to the beneficiary(ies).

Living benefits

To safeguard against the potentially devastating impact a life-threatening illness or disability can have on you, your family and your finances, disability, critical illness, and long-term care insurance can offer coverage beyond that provided by government and employer benefit plans.

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i. Disability insurance

The ability to earn an income is important since it generally supports one's lifestyle. If you're unable to earn an income due to health issues or a disability, having adequate disability insurance coverage is important for meeting your living expenses and achieving your long-term financial security.

Disability insurance is designed to replace a portion of your income in the event you become disabled due to accident or illness and are unable to work. While your employer may offer disability insurance as part of their company benefits package, you should check the details of this policy as company benefits often only cover a percentage of your income. In this situation, it might be beneficial to purchase supplemental disability insurance coverage.

ii. Critical illness insurance

With advances in medical science Canadians are surviving illnesses that probably would have resulted in death in the past. But, while people are surviving, the same may not be true for their finances. A critical illness such as cancer, heart attack or stroke can have a devastating impact on your financial well-being. You may be unable to work and medical bills not covered by government and company health plans can mount up quickly. You may also incur unexpected expenses throughout your illness and recovery that don't qualify for traditional health plans. Without critical illness insurance, it may be necessary to draw on your investment portfolio to cover these costs, which could significantly impact your retirement savings.

Once diagnosed with a qualified illness, a critical illness insurance policy generally pays a tax-free cash benefit (typically about 30 days after the initial diagnosis, and assuming you survive), which is equal to the amount of insurance you purchased. How you use the money is entirely up to you. You can use the benefit to take a sabbatical and recuperate, help pay off your mortgage, make renovations to your home to accommodate any special needs, inject money into your business to keep it going while you're recovering, or even pursue private medical treatment outside Canada. The flexibility provided by critical illness insurance benefits can help alleviate financial worries during this time.

iii. Long-term care insurance

The rising cost of long-term care can quickly erode your savings. Long-term care insurance, which can also be used to complement critical illness coverage, is designed to help people maintain their independence by providing the financial resources needed to control how, and where, they choose to live.

Long-term care insurance generally provides a daily tax-free benefit to cover the costs of a nursing home or professional in-home care. To qualify for benefits, a person must be unable to perform two or more Activities of Daily Living ("ADLs"). Common ADLs are bathing, eating, dressing, toileting and transferring. An example of transferring would be rising from a chair unassisted.

Conclusion

Regardless of your age or stage in life, insurance should be part of a comprehensive wealth management discussion. Having the proper insurance coverage in place can help protect you, your family, and your finances, and provide comfort in knowing that uncertainties can be overcome.

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Contact your BMO financial professional for more information.

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