PURCHASING LIFE INSURANCE – WHAT YOU NEED TO KNOW

A life insurance purchase is ultimately based on need. Needs can and will typically change over time, but the premise behind owning coverage remains: does the passing of an individual have financial consequence to others (a dependent, individual or entity)? When examining the issue of dependents, a spouse or family most likely come to mind. People generally understand the impact of the passing of a bread-winner or a stay-athome parent and its potential to devastate financially the ones we love.

In order to correctly assess the need, it becomes necessary to factor issues such as funeral costs, debts, a mortgage, loss of an income, funds for a child's education (or handicapped children), donations to charity, etc. By going through this simple, yet key exercise, one can clearly understand how a need defines itself. From this, a timeline for the duration of the coverage can then be determined. Policies fall into two broad categories: term and permanent.

<u>A TERM policy is coverage which has an expiry date</u>. When a specific need requires a term insurance solution, an appropriate length of term is usually chosen to deal with it. As an example, a loan or mortgage generally has an amortization period. This can be the guideline for the duration of the term. Another example is a parent with young children. The financial responsibility of bringing them to adulthood usually comprises a certain number of years. Since these costs and other responsibilities are often substantial yet limited over specific timelines, term coverage remains the most affordable solution. The cost is also proportionate to the length of the term. Thus a 10 year term is less expensive than a 20 year term. Built in to a term policy are two key contract clauses: a renewal provision and a conversion provision. The **<u>RENEWAL provision</u>** guarantees the insured the ability to renew the term for an additional and equivalent term WITHOUT having to re-qualify medically. Under the **<u>CONVERSION provision</u>**, the insured has the right to convert the term contract into a permanent one, usually at any time before one reaches a certain age. This again provides tremendous flexibility to the insured since a simple term policy can now provide potential lifetime coverage at a level cost.

<u>A PERMANENT policy, by definition, provides lifetime coverage</u>. This means that regardless of when death occurs, the proceeds of the policy will be paid out. Premiums are based on a lifetime responsibility of paying premiums. Some contracts can offer the ability to pay for a set or anticipated period of time, while providing lifetime coverage. Under current tax law, one can also contribute additional premiums (beyond the actual cost of the insurance) and have these grow taxdeferred. This can be a very attractive long-term strategy when additional funds are available. There are also attractive ways of accessing the funds (typically at retirement) through a leveraging strategy, thus incurring no taxation on "withdrawal". Permanent coverage has many benefits; it does require nevertheless, a greater understanding of its mechanics as well a clear understanding of its long term implications.

Pierre Jeaurond is a Living Benefit Specialist and an independent broker, based out of Ottawa. Since 1989, he has focused his practice on such issues as Critical Illness protection, disability coverage and life insurance.
He can be reached directly by e-mail at pierre@ifs-asf.ca or by phone at 613-798-2424