



## The Three Uses of Life Insurance

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There are primarily three opportunities to utilize insurance in the process of generating a financial or estate plan. Insurance bridges the gap between current financial planning during our working and retirement years and estate planning for the efficient distribution of our assets.

We also recognize that insurance plays a key role in risk management. It resolves issues around the risk of a premature death and the subsequent effect it has on wealth creation. Insurance also addresses the risk of estate shrinkage on death due to capital gains and income tax liabilities. Lastly, insurance eliminates current taxation on pools of capital exposed to taxes on fixed-income investments.

### **Wealth Creation:**

Life insurance, in this context, is used to create wealth that would have otherwise been created if not for the premature death of the contributing spouse. Typically, these clients are younger with debt that would include but not be limited to a mortgage, education and childcare expenses. The surviving spouse would be financially compromised if there were no money in place to place to retire debt and fund for education and other childcare expenses. Because discretionary cash flow is at a minimum, the insurance solution is typically renewable and convertible term insurance. Renewable means that at the end of each term the policy can be renewed without evidence of insurability. Convertible means the policy can be converted to any permanent plan the issuer has available at time of conversion. Again, this can be done without evidence of insurability.

### **Estate preservation:**

This type of strategy is the most cost effective method in funding the tax liability associated with the disposition of assets at death. The calculation of which is determined by either a projected growth rate of that asset to life expectancy and calculating what taxes will be attributed to the specific assets held. It is recognized that this is always a moving target and all calculations are approximations. Should the taxpayer sell or give away the asset while they are alive, then taxes will be paid at the time of disposition. In this case, the type of insurance that is applied for is permanent, either with a fixed death benefit or one that grows with the outstanding liability.

## **Tax-Exempt Investing:**

This is by far the most exciting opportunity for clients with disproportionate amounts of their portfolio in fixed-income instruments. Most of these clients have been either GIC refugees from the past or they are business owners or senior executives that have taken enough risk in their primary occupation and want to shepherd their funds from future loss or market volatility. However, these individuals espouse the tax slips they get every year knowing that they have to pay tax on the income that their pool of capital generates and on which they have not spent. Coupled with inflation, they find their purchasing power eroded annually.

The insurance industry recognizes that utilizing the tax-exempt investing is appealing to these individuals, however life insurance is not. To that end, the industry has created strategies and products that effectively position insurance as a tax-exempt investment that complements a client's existing portfolio. A client 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 total cost of running the portfolio within the plan becomes negligible.

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, the death benefit flows to the estate or a named beneficiary tax-free. 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 dependants or provide a social legacy for charities, trusts or foundations.

To summarize, life insurance can satisfy a number of wealth management objectives. Insurance products, not unlike the marketplace we serve, have become more sophisticated and complex over the years and these types of plans are increasingly gaining acceptance among affluent Canadians and the tax and legal advisors that serve them.

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