Business Outlook

Make informed choices when insuring your life

Life insurance is a fundamental part of your financial plan. It helps Canadians protect themselves against the loss of income due to death, disability, or retirement.

What are the main types of life insurance policies and what are the essential differences between them?

There are two main categories of life insurance policies — **whole life** (in a variety of forms) and **term.**

Whole life which is also known as "straight life", "permanent life" or "ordinary life", provides protection for as long as you live. You pay the same premium throughout your lifetime with part of the payment accumulating as cash value and dividends. It is this cash component that can be used as the basis for a low interest rate policy loan, or removed from the policy either in a lump sum or over a specified period of time.

Term insurance, as its name implies, covers you for a specified period of time — usually one to 25 years — or to age 70. When the term ends, so does the policy and its protection.

Most term policies are renewable, usually without health checkups. However, each time you renew the policy, the premium rises significantly to reflect your advancing age and the increased likelihood of death. The majority of term insurance policies do not provide cash values or the other options found in whole life insurance.

During recent years, a popular variation of whole life has been "universal life", which combines an investment return on cash values with a built-in flexibility in the amount of life insurance protection. Universal life consists partly of term insurance and partly investment. You designate how much insurance protection you want and how much you want invested in low-risk financial instruments. Policy owners must keep in mind that the cost of the term insurance component increases as you grow older. Also, the insurance coverage continues only as long as there is enough money in the fund to pay premiums as they come due.

Have the benefits offered by whole life insurance been outdated by the initial low costs of term insurance and the investment yields of universal life?

Unlike term insurance, which pays only if you die within a specified period of time, whole life pays whenever your life terminates. It is permanent life insurance.

Whole life is also very flexible, providing numerous options in the way you pay premiums, how you use the protection, and how benefits are received. The following are a few examples:

- You can borrow money from your life insurance company up to the cash value of your policy.
- You can stop paying premiums and continue the protection for a specified period of time, rather than for the rest of your life.
- You can discontinue your protection entirely, and have your company convert the accumulated cash value into an income for you.
- You can cancel the policy entirely and receive a cash payment — the cash surrender value and dividends, if any.

There is no "right" or "wrong" policy for everyone. Your selection of life insurance should be based on your family protection needs. It is an integral part of your long-term financial plan.

How much life insurance do you need?

To determine the amount of life insurance that is right for you, consider the income your dependents will need for living expenses, educational needs and other future expenses, taking inflation into account. In this total should be included cash requirements for the expenses of final illness, taxes, mortgages or other debts.

Generally speaking, financial experts say that you should have life insurance coverage equivalent to five times your annual income. Another valid approach is to insure yourself to an amount calculated by projecting your present earnings at a modest increase of 5% per year until the normal retirement age of 65.

There is no handy formula or slide rule to show how much life insurance an individual should have. The "right" amount is a highly personal matter which should be determined through talking to your spouse and your life insurance agent or Chartered Life Underwriter.

For further information contact Life Underwriters Association of Canada, 41 Lesmill Rd., Don Mills, Ontario, M3B 2T3, (416) 444-5251, or speak to your local life underwriters association.

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Start 1989 RSP savings now

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Paul J. Rockel

(NC)—Jim, John, and Jerry, (our mythical friends) have been saving $2,400 per year into their RSP's for the past 20 years.

They are now about to retire, and looking forward to the day with glee. They each prided themselves (as they should) on having the foresight to have saved that $2,400 per year into their RSP's. *True, each of them had saved* over 33% per year in taxes ($800 per year), so the TRUE COST was only $1,600 per year ($133.33 per month).

"Just imagine" said Jim, "we now have the time to look after our house repairs, do the things we've always wanted with our time, and to travel and see the world."

"And" replied Jerry, "we now have the income to do all those things, again, thanks to those RSP savings. I expect to take $3,500 per month from my Registered Retirement Income Fund (RRIF) and expect to have the dollars grow besides. That $350,000 in my RRSP sure looks great."

"350,000!" shout both Jim and John. "We don't have that amount in our RSP'S!"

And so they discussed how they had saved their $2,400 per year. It was discovered:

JIM had saved his $2,400 per year in a savings institution where he had averaged 10% (over the 20-year period).
JOHN had put $2,400 per year into a mutual fund that had averaged 15% per year.
JERRY had put $200 per month ($2,400 per year) into the same mutual fund as John had used, averaging 15% per year.
JIM was worth $151,200 (savings institution).
JOHN was worth $282,000 (mutual fund)
JERRY was worth $350,000 (same mutual fund).

All had invested exactly the same amount, $48,000 over the 20 years. But they had different dollar amounts available now for their retirement.

Jim had saved his $2,400 per year, and his important objective each year was to reduce his taxes. He gave little or no thought to what his savings were growing at, and so left it at the savings institution, figuring a 10% average "was pretty good" (it is).

But both John and Jerry, while interested in the tax savings also, looked for ways to achieve a better rate of return, and found that most good mutual funds have averages of 15% and better per year, if you look at 10-year results and longer.

But, both of them used the same mutual fund, and invested the same amount of monies each year. Why does Jerry have over $50,000 more than John?

The answer is obvious. They both "earned the same", but John put in $2,400 per year, each February, whereas Jerry contributed $200 PER MONTH (using a pre-authorized cheque plan whereby it automatically was invested for him each month).

Let's use our calculator for a bit.
$2,400 per year X 10% (Jim) X 20 years= $151,206.
JOHN: $2,400 per year X 15% X 20 years=$282,744.
JERRY: $200 per month X 15%(1.25% per month X 20 years (240 months)=$303,190.

Even the calculator tells us that Jerry (monthly mutual fund saver) has double the amount of Jim (institutional saver), and that he has $20,000 more than John, who saved in the same mutual fund. The reason is that Jerry saved MONTHLY.

But, by using equity funds, Jerry ends up with even more gain, because something called dollar-cost-averaging was working for him. By investing regularly during both the ups and downs of the equity funds, he was sometimes buying bargains, which gave him an average better rate of return than 15%, despite the fact the fund "averaged" 15%.

Would you like more in retirement? Maybe you should consider investing monthly, rather than just once a year (as so many of us do). Start next year's monthly RSP contributions NOW.

PAUL J. ROCKEL is author of the book "Why I Invest In Mutual Funds" and president of Regal Capital Planners LTD.
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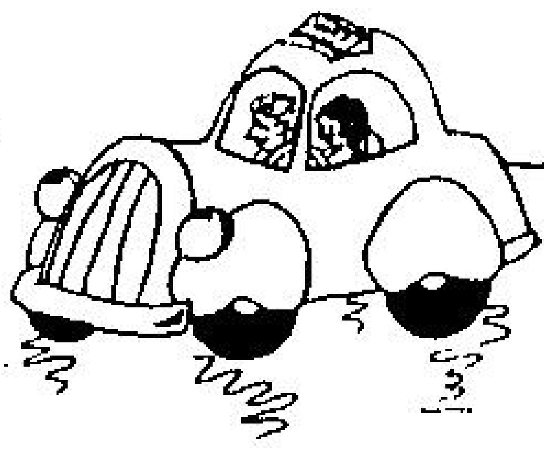

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