Life insurance for the wealthy

The myth-busting benefits

Sun Life

We help. You grow.

Key insights

- ✓ Insurance can help preserve affluent lifestyles
- ✓ Permanent life insurance can protect or enhance financial capital
- ✓ Permanent insurance is an asset class worth considering

There are grains of truth to many myths, but others simply don't stand the test of time. For example, years ago parents would tell their kids to dress warmly so they wouldn't catch a cold. But medical professionals busted that myth when they discovered that cold air doesn't make you sick.

There's a persistent myth about life insurance too: "the wealthier you are, the less you need it." Like many other generally accepted "truths", this one appears logical on the surface. But dig a little deeper and you'll find a different story.

Consider a typical scenario for an affluent, middle-aged couple who own a successful business. Their kids are financially independent adults, they own a beautiful home and their business has prospered. Their business is a valuable asset and gives them a steady annual income.

Life insurance was essential protection for this couple 25 years ago when their debt was high and their kids were young. But today, with no mortgage and millions in investment and business assets, we'd be tempted to say they no longer need it.

But they do.

While the couple has more than enough financial security to meet their basic living needs, the surprising fact is this: they can get even more benefits from a life insurance policy. That's why we wrote this guide – to bust the most prevalent myths that surround life insurance.

The more you have, the more you have to lose.

The need for money and ongoing cash flow doesn't decrease with wealth, it increases. The higher an individual's pre-retirement income, the greater the percentage of income replacement needed to maintain their lifestyle in retirement.

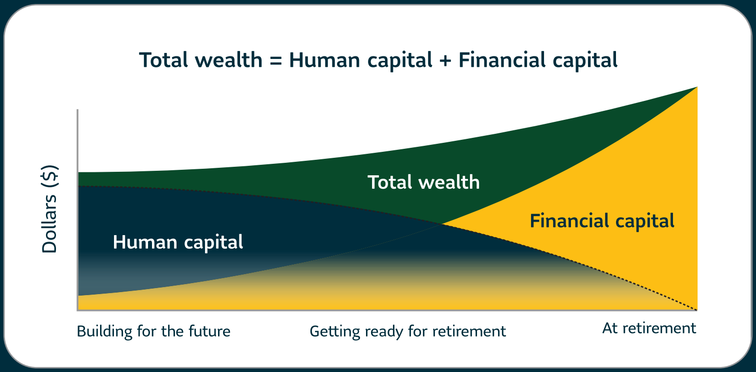
There are two key areas where life insurance can benefit wealthy individuals:

Human capital

Benefit: protecting the value of an individual's income earning potential.

Financial capital

Benefit: growing and protecting assets that an individual already owns, and which make up their net worth (real estate holdings, a business, investments).



Life insurance is wealth protection. What do wealthy individuals need to protect?

- **Myth:** The wealthy don't need life insurance.
- **Fact:** Insurance can help maintain affluent lifestyles.

Human capital

Income and lifestyle protection

While the need to protect human capital typically declines as individuals approach the end of their income-earning years, it may still have an important role to play for wealthy individuals with some earning years left and a lifestyle they want to maintain.

Let's go back to the successful business couple we mentioned earlier. Let's imagine they continue drawing income from their business each year and don't plan to retire for another 10 years. A term insurance policy – which provides insurance protection for a specific period of time and is the cheapest form of insurance –could be put in place to help protect this income stream if an early death occurs.

Likewise, a disability insurance policy could protect this income stream if one of the business owners becomes disabled and is unable to work.

Lastly, critical illness insurance – which pays a lump sum amount upon the diagnosis of a major illness if the individual survives the required waiting period – can be instrumental in covering some of the high costs that can stem from such an illness. The couple can use the payout from the policy towards whatever they need, such as financing a leave from the business, hiring staff at home or at work or managing their ongoing credit costs. This helps preserve the investment nest egg the couple has built.

Affluent individuals have a lifestyle they're accustomed to and want to maintain. They shouldn't underestimate the impact a serious illness can have on it.

Individuals will generally target 100% living standards replacement rate (LSRR) to ensure living standards [continue] in retirement. The LSRR is a comparison of the amount of money a worker has available to support their personal consumption of goods and services before and after retirement.

— Dr. Bonnie-Jeanne MacDonald, Replacing the Replacement Rate: A Better Way to Determine Retirement Income Adequacy, Society of Actuaries Article from International News, 2017.

70%

Chance that someone turning age 65 today will need some type of long-term care service in their remaining years.

— LongTermCare.gov, U.S. Department of Health and Human Services, 2020

- **Myth:** As wealth increases, the need for insurance decreases.
- **Fact:** Permanent insurance can protect or enhance an individual's financial capital.

Financial capital

Estate, business, and lifestyle planning

While life insurance offers "human capital" protection, it's the "financial capital" benefits that affluent individuals miss out on by buying into the myth that life insurance isn't for them.

As an individual's wealth grows, their need for estate, business and lifestyle planning increases. Life insurance can play a valuable role in each of these areas - not just protecting wealth but also growing it.

Here's an overview of some of the ways you can use insurance to protect or enhance financial capital.

As wealth grows, the need for estate, business and lifestyle planning increases.

For secure investment goals – Clients can use insurance as an alternative asset class

When we think of investment asset classes, we usually think of stocks, bonds, real estate and cash investments. But permanent life insurance policies can produce better after-tax rates of return than more traditional, conservative investments like Guaranteed Investment Certificates (GICs) or government bonds.

Once individuals maximize their tax-preferred saving opportunities—Registered Retirement Savings Plans (RRSPs), Individual Pension Plans (IPPs) and Tax Free Savings Accounts (TFSAs)—they have limited options for tax deferral or tax savings. For individuals who have enough savings to finance their retirement income needs and are looking to minimize tax and maximize their estate's value, a permanent insurance policy can provide significant benefits:

1. A tax-free death benefit
2. Tax-preferred investment growth
3. Avoidance of estate settlement costs such as probate fees

Providing additional tax-free retirement income

While permanent life insurance can be an excellent way to build estate value, it can also be used as an additional tax-efficient source of retirement income.

The most common method of doing this is by using the cash surrender value of the policy as collateral for a loan from a financial institution. The financial institution gives the individual a series of loans, for which the insurance policy is the collateral. Under current tax laws, the loan proceeds are received tax-free.

The loan arrangement can be structured so that no interest is payable on the loan until death. Upon death, part of the death benefit goes to pay out the loan and the remainder goes tax-free to named beneficiaries.

Individuals can also access the value of their insurance policy through a direct withdrawal of its cash value, or through a policy loan directly from the insurance company. However, a withdrawal or policy loan could trigger tax consequences depending on the adjusted cost basis of the policy. For this reason, a loan arrangement from a third-party financial institution is the most common method of generating additional income in retirement

5.3%

of Canadian households own $1M+ in assets. Projected to reach 7.3% by 2028.

— Investor Economics Household Balance Sheet report – Canada, 2020

Making the most of charitable giving

While many affluent individuals would like to make a substantial charitable contribution beyond their annual support, they (or their estate) may not have the liquid cash to make it happen. One affordable solution is to use life insurance to make a charitable bequest.

To donate using insurance, the individual can apply for permanent insurance. Once the policy is approved, they can transfer ownership of the policy to a charity and name the charity as the beneficiary. The individual pays the annual premiums and receives a tax receipt each year for that amount.

The insurer guarantees the death benefit to the charity, provided they continue to make premium payments. In addition, the insurer makes the payment of the death benefit outside of the estate, so the charity receives the proceeds quickly and with no probate fees payable on the amount. Another way to use insurance proceeds is to replace the cost of a charitable gift at death. The individual can make a direct charitable bequest in their will. The charitable tax credit is used to reduce income taxes payable by the estate. The proceeds of the life insurance policy go to the children or other beneficiaries to offset the cost of the charitable gift and ensure they get the full intended inheritance.

Covering estate tax liabilities or equalizing the estate

When an individual dies, they are deemed to dispose of all their capital property – and their estate must cover the taxes on any capital gains. In addition, tax-preferred assets held in registered plans (such as RRSPs and RRIFs) become fully taxable upon death, unless they rollover to a qualified beneficiary such as a spouse or minor child.

There can be other expenses as well. Probate fees, paid by the estate to the government to confirm the validity of a will, can amount to thousands of dollars depending on the province of residence. In Quebec, although probate fees aren't applicable, court verification fees apply for non-notarial wills.

The proceeds of a life insurance policy can be an ideal way to cover some or all of these estate expenses. The death benefit is non-taxable and can provide an estate with the readily available cash needed to ensure that non-liquid assets, such as a cottage or a business, don't have to be sold to cover its liabilities.

These proceeds can also be used to equalize an estate among beneficiaries. For example, if an individual owns a business and wants one child to assume ownership and control, they can use their life insurance proceeds to provide an equal share of the estate to their other beneficiaries without needing to sell their other assets.

Business uses for insurance

For business owners, insurance can play a number of key roles:

Funding a buy-sell agreement:

If there are multiple business owners, a buy-sell agreement sets out the conditions (such as death, disability, non-contribution due to serious illness) under which one owner has the right to buy the ownership share of other owners.

To be effective, the agreement needs to be funded in a way that won't cause financial hardship to either the company or the partner being bought out. One of the most effective solutions is buying life, disability and critical illness insurance for each owner. When an owner dies or becomes disabled or ill, the company (or the surviving owners) can use the insurance proceeds to buy out the partner's business interest.

Providing key person insurance:

Losing a key owner or employee through death, disability or critical illness could have a significant business impact. The business loses the input of a valuable member, creditors could withdraw financing and customers might go elsewhere. In addition, there could be significant out-of-pocket costs involved in recruiting and training a suitable replacement.

Life, disability and critical illness insurance can provide the funds necessary to keep a business operating should a key person suffer an unexpected illness, accident or death. The business is the beneficiary of the policy and can use the funds for any number of business purposes, such as recruiting or training a replacement, providing supplementary cash flow to replace a decline in business income, or paying suppliers.

Tax-effective transfers:

Businesses can also structure insurance arrangements so that some or all of the insurance proceeds are used to pay tax-free capital dividend payments from the corporation to its shareholders. There are a number of variations on how businesses can structure such arrangements, depending on the situation and business purpose.

- **Myth:** Insurance has no place in the portfolio of the wealthy.
- **Fact:** Permanent insurance is an asset class worth considering.

The insurance opportunity

It's time to bust the myth that insurance has no place in the portfolio of affluent individuals. As age and wealth increase, what was once a necessary protection expense becomes a valuable financial opportunity.

Insurance products add value for insurable business owners and affluent individuals in so many ways such as enhanced retirement income, business protection, estate preservation, and tax-efficient wealth transfers. It's an investment worth exploring.

The wealthy might not think they ***need*** insurance but that doesn't mean they don't ***want*** it.

Need term insurance (Protecting human capital)	**Want permanent insurance** (Protecting financial capital)
• Replace income in the event of premature death of a key person or breadwinner • Meeting shareholder buy-sell obligations	• Protecting the value of an investment portfolio in the event of illness • Intergenerational transfers • Low risk asset class • Estate equalization tool • Philanthropic gifting • Tax-effective transfer of assets from a corporation • Fund tax liabilites

Life insurance and the wealthy

The myth-busting benefits

Insurance can help preserve affluent lifestyles

The need for money and ongoing cash flow doesn't decrease with wealth, it increases. The higher an individual's pre-retirement income, the greater the income replacement they'll need to maintain their lifestyle in retirement.

Permanent life insurance can protect or enhance financial capital

As wealth grows, the need for estate, business and lifestyle planning increases. Life insurance can play a valuable role in each of these areas – not only for protecting wealth but also for growing it.

Permanent life insurance is an asset class worth considering

Typically, the benefit to the estate upon death is significantly greater if individuals put some of their money into a permanent life insurance policy instead of a non-registered investment. Since death is 100% certain, permanent life insurance is worth considering as an alternate asset class.

BIOGRAPHY:

Wayne G. Miller, BMATH, ASA, ACIA

Associate Vice-President, Marketing & Business Development, Sun Life Financial

Leading the advice revolution.

Over the course of Wayne's 30 years at Sun Life, his respect for advisors and the value of advice has only grown. As the holder of Associate designations from both the Society of Actuaries and Canadian Institute of Actuaries, he spent the first 10 years of his career in product development, with the balance being in Marketing and Distribution.

In his current role, Wayne oversees the B2B marketing function as well as a team of business development thought leaders that disrupt, inspire and enable advisors on: 1) professional development; 2) practice management; 3) marketing & branding and 4) Client engagement.

He has deep respect for the crucially important work advisors do every day to give their Clients priceless peace of mind, and is committed to providing innovative tools, coaching and information to help them address their Clients' financial literacy gap. At the core of his philosophy is "no regrets." That is why he is leading the advice revolution - a movement that inspires every Canadian to create a meaningful legacy – because they understand and respect the financial services industry and the advisors that serve within it.

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