

# RISK Management: Life Insurance

One buys life insurance because they either love someone or they owe someone.

**D**uring my career as a certified financial planner, I have rarely met anyone who bought life insurance and then found any enjoyment from spending their hard earned money on paying the premiums. However, over the last decade I have never heard of a life insurance beneficiary say after making a claim that the departed had too much insurance.

The reasons an individual purchases life insurance arise from their basic desire/need to protect someone or something financially in the event of their premature death. For most people, not owning life insurance at death would otherwise leave outstanding unfulfilled financial obligations, such as not having enough funds to support dependents, educate their children, and pay taxes or mortgages. In essence, one buys life insurance because they either love someone or they owe someone.

Over the last few years while teaching Risk Management to my students studying to become this country's future certified financial planners, the question that often arises is, "What steps should Canadian consumers embrace when considering buying life insurance?" My reply is that Canadian consumers should apply the Six Step Life Insurance Needs Process, this process determine if there is first a need for insurance, and if there is, it allows them to decide how much life insurance is needed so they will mitigate their financial risk.

## The six step life insurance 'needs process':

### Step 1: Determine whether you need life insurance.

If you own your own business and you die prematurely, you

might need insurance to contribute to the company's cash flow to replace yourself as a contributing member to the bottom line. Or if you are married with children, by having the proper amount of insurance your family will receive enough money to replace you as the breadwinner. Some of your needs for life insurance coverage might be temporary in nature such as paying for your children to go to university or to pay off the mortgage. If you have accumulated a lot of assets in this lifetime, you may need life insurance to pay taxes after your death on your estate.

On the other hand, if you are single without dependents, you might not have a need for insurance at all. Remember insurance is exactly that, it is insurance, it should never be bought for the primary purpose of investments.

### Step 2: Estimate the amount of life insurance you need.

In this step of the process a life insurance needs analysis is completed. A balance sheet is created, which adds up all your life insurance policies and other financial and material assets, then subtracted from that amount are all your financial liabilities. A person's liabilities don't just include their mortgage and credit card debt but also the loss of their human value. Human value is calculated based on the present value of one's contribution to their family's income and lifestyle, today and in the future. For example, an individual who earns \$100,000 today, their family may require 60 percent of their gross income to meet current and future financial obligations. The difference between a person's assets and liabilities, if any, is the amount of new life insurance that should be

purchased. If you own life insurance and your agent has not done this step, most likely you own the wrong policy and have the wrong coverage.

### Step 3: Decide the best type of insurance for you.

The next step in the process is to decide what type of insurance best suits your situation. The best policy is the one that best meets your financial needs. If the amount of money you can spend on life insurance is limited, or if you have a temporary need, consider term insurance. If you need lifetime protection, consider permanent life or universal life insurance. At all cost avoid purchasing a life insurance policy that you cannot afford. Twenty percent of life insurance policies lapse for non payment of premiums during the first year.

### Step 4: Shop around for a low cost policy.

Each insurance company has different cost structures for their term, permanent and universal life insurance products. Shopping around for low-cost life insurance policies can save you thousands of dollars during the life of a policy.

### Step 5: Consider the Financial strength of the Insurance Company.

Do you remember Confederated Life? It was an insurance company that was founded before the Confederation of Canada in 1867, and it went bankrupt several years ago. Yes, insurance companies do have the potential to go bankrupt. There is the Canadian Life and Health Insurance Compensation Corporation (CompCorp), founded in 1990 to protect Canadian policyholders against loss of benefits or unpaid claims under their life insurance contracts, should a CompCorp insurance company member collapse. However, it should be noted that CompCorp does not receive any financial support from federal or provincial governments and it is a voluntary organization. Therefore, it is important to buy life insurance only from financially sound insurance companies. There are a number of rating organizations that periodically grade the strength of these companies.

### Step 6: Deal with a competent Certified Financial Planner (CFP) or Chartered Life Underwriters (CLU)

To receive the right advice and to be sold the right policy, you should

consider your agent's experience and professional qualifications. Certified Financial Planners (CFP) and Chartered Life Underwriters (CLU) are technically competent in the area of life insurance. These individuals who have attained either the CFP or CLU designations must continually meet education, examination, experience and ethical standards.

One last thing, as our lives change, so do our needs and the amount of life insurance we should own. Thus it is important as a rule of thumb to sit down with your life insurance agent to take you through the Six Step Life Insurance Need Process to make sure you have the proper amount of coverage that best suits your life circumstances now and in the future. **DPM**

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