Whole life as an investment tool

Clients who can afford whole life insurance may benefit by using the product as part of an investment plan as well. While the strategy has its advantages, it might not be suitable for all clients

BY DWARKA LAKHAN

WHOLE LIFE INSURANCE CAN BE AN attractive option for clients seeking lifetime insurance protection. But it is also increasingly being used as an alternative investment vehicle to build wealth and create value for future financial needs.

Using whole life insurance for investing is a much debated issue. The crux of the debate centres on the role of whole life as insurance, as opposed to its role as an investment tool. Other important factors are the product's cost relative to cheaper term insurance and the availability of more suitable investment alternatives.

Clients who choose whole life, as opposed to term insurance, are typically 40 years or older with "high incomes and excess free cash," says John McVittie, president of **APK Wealth Retention Inc.** in Toronto. These clients can afford the cost of whole life insurance and normally pay premiums for a limited period, perhaps five or 10 years, to obtain coverage for life.

From an insurance standpoint, this strategy gives clients the psychological comfort that they are insured for life at an early age and takes away the worry about having to pay higher premiums as they get older, says Raymond Yates, senior partner at **Save Right Financial Inc.**, a Mississauga, Ont.-based managing general agency. Clients get a guaranteed policy with premiums that do not change and benefits that are defined.

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On the investment side, the considerations are different. The decision to use whole life as an investment tool "is a business decision [about] the best place to put free income," says Lawrence Geller, president of **L.I. Geller Insurance Agencies Ltd.** of Campbellville, Ont. "Generally, the longer you need insurance, the better the decision to use whole life."

When insurance is used as an investment vehicle, policyholders recognize that the cash value that builds up in these policies can be used for a variety of financial and estate planning purposes, such as augmenting retirement income, collateral for a loan, offsetting capital gains taxes payable on death, estate equalization and charitable giving.

The investments supported by a whole life policy can grow in a variety of ways — in a tax-sheltered environment. The cash value grows faster when the policyholder deposits or invests in excess of what is required to cover insurance and policy costs. The excess amount attracts dividends or performance credits, which grow tax-free within the policy.

The cash value is usually invested in a professionally managed, diversified investment pool that is designed to generate relatively stable, long-term returns. Growth is usually steady but not spectacular. Clients who use whole life as an investment tool should recognize that it is an asset class that is not designed to provide double-digit returns, says McVittie, although the investment may provide higher long-term returns than major stock market indices.

If the insurance is no longer required, the policyholder can cancel the policy and withdraw the cash value as a lump sum at a future date, a decision that is normally determined by policy design and policy performance. Or the policyholder can borrow against the cash value of the policy to fund retirement or other financial needs, allowing the policy to remain in force; when the policyholder dies, the death benefit is used to pay off the loan and the excess proceeds are paid to the beneficiary tax-free.

Your clients need to be clear about the purposes of the policy they have purchased. Says McVittie: "Whole life should be viewed as insurance first."

Geller agrees, adding that the need for insurance must be established, and such needs will vary at different stages in a client's life.

Whole life is generally less flexible than term insurance when it comes to accommodating changing life needs, which is why term life is often considered the better choice for many clients. For instance, rather than buying whole life, clients can opt for cheaper term insurance and invest the difference in traditional vehicles such as investment funds. Clients can renew their insurance coverage as their needs change.

But no one really knows how long they will need insurance coverage. Some clients may find that they need insurance for a longer time than originally anticipated, Geller says. But the cost of renewal can increase significantly as a client gets older and can be more expensive than whole life acquired at a younger age — another reason why some clients choose whole life.

Universal life is another form of insurance that combines insurance with investing: it differs from whole life in that policyholders are required to make their own investment decisions. As a result, whole life is often viewed as a better alternative to universal life; clients who choose whole life do not want to worry about having to make investment decisions.

"It's one less burden," McVittie says, "one less decision for them." IE