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How to choose life insurance

Four essential concepts to understand before taking out a life insurance policy.

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Setting up a life insurance policy as part of a comprehensive financial plan can be relatively easy or relatively complicated, depending on the financial situation of the person in question. While a simple need for coverage could lend itself to a quick decision, strategies incorporating a tax and estate planning component could require the knowledgeable expertise of a financial security advisor and his or her team of specialists.

Here are four basic concepts to keep in mind before considering this kind of strategy.

1. **A source of protection**

The basic purpose of life insurance is to provide an income for the people whose standard of living depends on you, in the event of your death. However, since life insurance pays a lump sum instead of a monthly amount, it can be tricky to figure out the amount of capital required to generate an adequate income stream for the number of years required. For example, \$500,000 in life insurance might seem like a considerable amount, but it could be insufficient if you earn \$150,000 per year and your family depends entirely on that amount.

As well, life insurance can be taken out by business partners as a way of ensuring the continuation of their business operations should one of the partners die. In this case, estimating the amount of coverage required can be especially complicated, along with how the different policies should be held: by the company or by the individuals.

Finally, insurance can also be used to cover taxes and other major expenses after death.

2. Life insurance is not taxable

As a general rule, life insurance benefits are tax free for the beneficiary. However, any income subsequently generated by that capital will be taxable, and so will the policy's cash value, if any. As well, it should be noted that certain tax optimization strategies that made use of life insurance have largely been phased out due to legislative changes made in 2017.

3. Main types of life insurance

Life insurance is generally divided into two main categories: term insurance, which focuses on coverage, and insurance that adds a savings or investment component to the coverage. Included in this second category are permanent, or "whole life," insurance and universal insurance.

Term life insurance, with a term of 5, 10 or 20 years, provides guaranteed coverage for the term of the policy. The premiums are generally low, but will increase on renewal.

Term to 100 insurance is another form of insurance generally focused on coverage alone, making it more affordable than whole life, but which guarantees coverage for life.

Whole life insurance provides lifelong guaranteed coverage and includes a cash value – taxable if the policy is surrendered – that may eventually be used by the insured, for example as collateral for a loan. The premiums are much higher, and remain level over the years of coverage.

Finally, universal life insurance combines guaranteed lifelong coverage with an investment component. The cost of premiums will vary depending on the need for insurance versus investment.

4. An insurance plan for each strategy

Young families will usually choose term insurance because it can give them significant coverage at a very affordable cost. Nonetheless, financial security advisors might recommend permanent insurance to meet certain other needs, such as guaranteeing a person's future insurability.

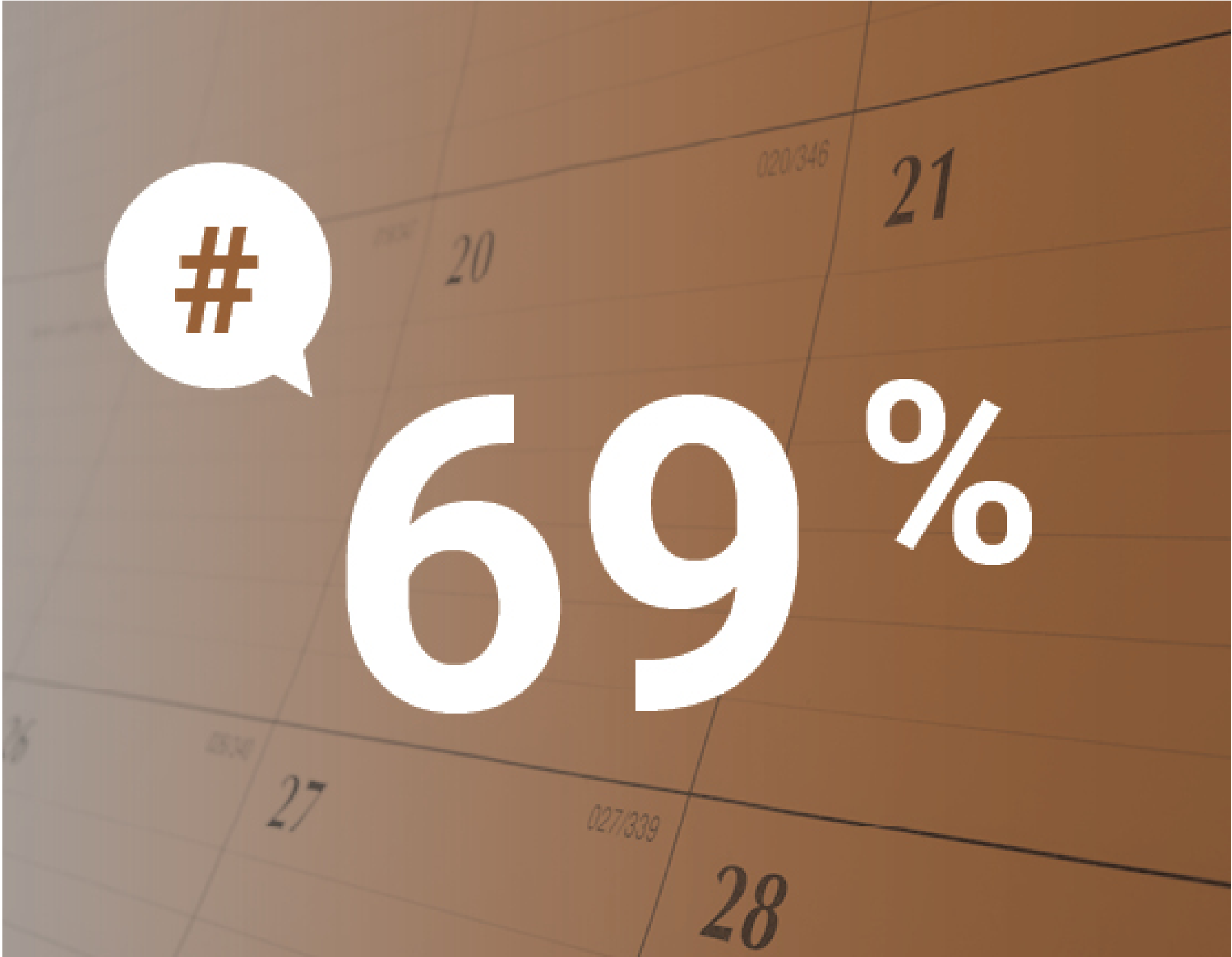
Moreover, considering the importance of life insurance in terms of tax and estate planning and in the context of a business, it could be important to look at every option before choosing a solution. To find out more about this topic, contact your financial security advisor.

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