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When to consider life insurance as an option for children

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Having spent his career selling insurance, Lorne Marr didn't hesitate to buy life insurance for his three children.

"I'm a believer in life insurance for children," says Mr. Marr, founder of LSM Insurance in Woodbridge, Ont. and director of business development at Hub Financial Inc.

"You can lock in a child's current state of insurability, and that can be a huge benefit if the child develops health issues later in life," he says.

Life insurance can be purchased for infants as young as 15 days old. And depending on the type of product, it can go far beyond covering funeral costs – an unlikely scenario with a child – and offer several financial benefits for a fairly low premium.

Many types of life insurance grow cash value tax-free over the child's lifetime, providing a death benefit and a cash value portion that can be borrowed against to fund purchases. Then, there are guaranteed insurability riders that mean when the child applies for more insurance in the future, they won't have to fill out a medical questionnaire.

Life insurance options for children

Life insurance for children is available as a term policy, a whole life or universal life policy, or as a rider on a parent's policy.

Participating whole life and universal life are the most common products purchased for children, says Michael Aziz, chief distribution officer, Canada division, Foresters Financial in Toronto.

"Both can provide opportunities for the insured child to leverage the cash or fund values for any number of financial needs," he says.

That might include paying tuition, funding a down payment, starting a business or providing a source of retirement income later in life.

Here's a closer look at these two options:

Participating whole life insurance is a type of permanent life insurance that provides lifelong protection with fixed premiums and a guaranteed tax-free death benefit. It also has a cash value that has guaranteed growth over the child's lifetime and dividends that are paid out every year.

"It's all tax-free within the plan as opposed to a savings account, in which the interest gets taxed each year," says Celeste Merey, investment advisor with Toronto-based Foster and Associates Financial Services.

These policies are very expensive if you buy them as an adult, Ms. Merey says. But if purchased for a baby, premiums are low, averaging $60 to $100 a month.

Whole life insurance can be designed to allow for infinite banking life insurance, a financial strategy that allows the policyholder to borrow against the cash value of the policy to fund big purchases or investments, Ms. Merey says. When the money is borrowed, it's repaid to the policy with interest, which then continues to grow tax-free.

“Banks love cash value life insurance policies,” she says. “They’re a very strong asset, so [the client] can get a very good interest rate.”

Universal life insurance is cheaper than whole life insurance. It has a death benefit that can be adjusted by the policyholder, as well as flexible premiums that can be set by the client, with a portion of these earning interest over time.

Policyholders can treat universal life plans like investment accounts, in which they deposit money and make decisions on how they want to see their funds invested.

These plans have cash value that generates interest and grows tax-free, but this growth can change depending on market performance and changing interest rates.

What clients should consider

Ms. Merey says that while demand for life insurance for children is low, she often mentions it to clients who have extra cash flow after they’ve contributed to a registered education savings plan.

“It’s giving your kids access to cash that grows tax-free before they’re eligible for a TFSA,” she says.

Other times, grandparents want to contribute to a grandchild’s future, Mr. Aziz says, and life insurance is another option.

While life insurance can be a great way of securing a child’s financial future, Mr. Marr cautions his clients that they should only invest in these policies once their own life insurance needs are looked after.

“The main [downside] would be if the parent took out insurance on the child before adequately insuring themselves,” he says.

Mr. Marr also reminds clients that most permanent policies generate very little cash flow in the early policy years. Families who purchase this type of product need to be ready for a long-term commitment.

Due to the complexity of these products, it’s incumbent on advisors to research the options and riders that exist and design a plan that will meet the client’s needs – for a premium that works with their budget – yet still yields growth, says Ms. Merey.

Mr. Aziz adds: “It’s best to view insurance as a tool in the tool kit that can form part of the overall financial plan being created for the child and the family.”