FP INVESTING

TOOLS OF THE TRADE

Whole life insurance can improve returns, reduce risk

The Financial Post takes a weekly look at tools that will help you make your investment decisions. This week: How life insurance can help improve your investment performance.

By David Pett

TV junkies will surely recall an infamous television commercial that began with the phrase, "It's Patrick, he took out life insurance."

Patrick, who couldn't wait to share his news with his aged parents, no doubt purchased his policy — like most do in this country — to simply provide financial protection for his family. But a lot has changed since the ad started running some 20 years ago.

A growing number of investors are now looking at life insurance as an attractive way to improve returns and reduce risk in their portfolios.

"This has been a good approach for a long time," said John Nicola, chief executive at Nicola Wealth Management in Vancouver.

"It may not be particularly well-publicized, but if you do your homework, this is a good way to get fixed-income exposure."

Not all life insurance policies, however, will do the trick. Term insurance, for example, is generally only appropriate for addressing the need to protect against early death.

Permanent insurance, by comparison, provides the same protection, but also the option to accumulate investments inside the policy, albeit at a higher premium than term.

Mr. Nicola said he uses insurance products for virtually all of his low-risk fixed-income holdings and currently earns an average return of 4% on these holdings, net of fees.

He said participating whole life or "par" policies offered by most of the country's big lifecos are particularly effective alternatives to bonds, mortgages and preferred shares in today's low-yield investment environment.

"We are not trying to replace stocks or real estate with it, but if you're 40% invested in fixed income, we're saying this is something to seriously consider, especially if you already have an insurance need already," he said.

The initial cost of pars are more expensive than universal life policies, but the increased premium comes with guaranteed cash values and annual policy owner dividends.

The cash value is invested in a professionally managed, diversified investment pool that often includes stocks, bonds and alternative investments such as real estate. The investment also grows in a tax-sheltered environment.

Mr. Nicola said there are several reasons why funds invested in a par insurance policy may outperform investments in a typical balanced portfolio.

For one, the size of the investment pool means management costs are very low compared to other types of investments such as exchange-traded funds or commission-based mutual funds.

Life insurance companies also allocate part of the insurance premiums to the participating account and then guarantee the value of that investment.

"In effect, the policyholder has no investment risk on the capital in their policy even though it is invested in a pool of assets that will change in value over time," he said.

"For example, if a person has a policy with a $100,000 cash value and then receives a $5,000 dividend, the policy will have a new guaranteed value of $105,000. That cash value will not decline even if there is a market correction."

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