The BMO® Insurance Insured Retirement Plan

BMO Insurance

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Introduction

Permanent life insurance is a flexible planning tool that contains both insurance and investment elements. Due to this flexibility, these types of products can be structured to fit many different financial planning objectives. In particular, there are several opportunities using The BMO Insurance Insured Retirement Plan that you may want to consider for your clients who require permanent insurance as well as a tax effective source of cash to supplement their retirement income.

With this plan, your clients can get the insurance they require, in addition to benefiting from the following:

- tax-deferred growth of premiums (net of charges) into the plan
- a conversion of taxable investments into non-taxable portfolio*
- a reduction in future taxable income since assets are transferred into a life insurance policy with tax-deferred accumulation
- access to a source of tax-free retirement income beyond Registered Retirement Savings Plans (RRSPs), Tax Free Savings Accounts (TFSA) and Registered Pension Plans (RPPs) limits via a third party line of credit (or other loan)
- an effective way of paying-off the loan through the tax-free proceeds of the policy
- depending on the plan, options to access living benefits including disability payouts, terminal illness advances and special death payouts on the first death of a Joint Last to Die policy

This combination, when structured properly, can create a powerful financial planning tool.

To help support your understanding of the mechanics of The BMO Insurance Insured Retirement Plan, we encourage you to read this Guide and use the latest version of our Wave illustration software to help you prepare personalized proposals for your clients.

Note: The ideas presented in this guide should be reviewed for suitability to individual circumstances. The information contained in this guide is general in nature and should not be construed as legal or tax advice. You and your clients are encouraged to seek the advice of other professionals such as legal and tax experts to ensure that the ideas presented are appropriate for the circumstances of the individual(s) for whom this plan is being considered.

*Certain limits apply to the tax-exempt growth within the policy. Refer to an illustration for a projection of these amounts.

The Opportunity

Permanent life insurance plans such as universal life (UL) and whole life (WL) can provide your clients with the insurance protection they need as well as source of future funds to supplement their retirement savings.

Your clients may be looking for life insurance as part of their overall financial plan which often includes preserving the value of their estate from the taxes that may be payable upon their death.

At the same time, these individuals who are typically in the wealth accumulation phase of their lives may understand the need for retirement planning but their ability to save for retirement is constrained by the limits placed on contributions to RRSPs, TFSAs and RPPs. The need to accumulate a sufficient flow of retirement income in a tax efficient manner is a challenge that they may face. Investment portfolios set aside for this purpose are typically what they rely on, but income tax can erode their growth significantly.

Depending on the profile of your client, The BMO Insurance Insured Retirement Plan may be an ideal opportunity to generate this required income in a tax efficient environment with the added benefit of permanent life insurance.

Target Market

Ideally, The BMO Insurance Insured Retirement Plan is targeted at clients with the following profile:

- individuals (or couples) age 35-55 and who require permanent life insurance
- are in good health and are able to qualify for life insurance
- are high income earners
- are in the wealth accumulation phase of their lives
- have maximized their RRSP and TFSA contributions
- foresee a gap in their retirement income needs
- have excess cash that they would like to save for retirement
- are comfortable with carrying debt

If your clients fit this profile, using The BMO Insurance Insured Retirement Plan, you can show them a tax efficient way to save for their retirement and how to get the permanent insurance they need – *all in one plan!*

The Solution

You may wish to use the following as a guideline to implementing The BMO Insurance Insured Retirement Plan. Depending on your client's profile, additional steps may be required and could require the involvement of other professionals such as those with legal or tax expertise:

Step	The BMO Insurance Insured Retirement Plan
1	Working with your client, determine the amount of permanent insurance they need and can afford.
2	Work with your clients to determine what portion of their investment portfolio could be earmarked for this strategy and how quickly those assets should be transferred into the policy.
3	Your client then applies for a whole life or universal life policy from BMO Insurance. In the case of universal life, they select an investment portfolio for the policy that suits their long-term objectives and risk tolerance.
4	Once the policy is in force, check on a regular basis to determine whether the accumulation in the plan continues to meet their original objectives. Adjust the plan, if necessary.
5	Once the policy has accumulated a significant cash value at retirement, if funds are required, they may then apply for a line of credit (or loan) from a third party lender using the policy's cash value as collateral. The proceeds from the loan may be drawn on a tax-free basis to supplement their retirement income needs.*
6	If the policy is leveraged, the interest on the loan may be capitalized or funded through additional borrowings. Alternately, your client may wish to pay the interest on the loan.
7	At death, the balance of the loan is paid using the tax-free Death Benefit proceeds of the policy.
8	The remaining death benefit can be used to settle the insurance risk originally identified.

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Why The BMO Insurance Insured Retirement Plan Makes Sense

Your client purchases a universal life or whole life insurance policy from BMO Insurance, with a stream of premiums that maximizes the tax-deferred growth in the policy. At retirement, the policy's cash value is pledged as collateral to secure a line of credit which may be used to supplement their retirement income on a tax-free basis. At death of the insured, the tax-free proceeds from the policy are used to pay off the loan.

*Based on Rules and Regulations in effect at the time of writing this Guide.

Note: Before proceeding with any proposal, you should determine the tax consequences of transferring assets from other investment vehicles into this plan.

The Results

By using the ideas of the Insured Retirement Plan from BMO Insurance, your clients will benefit from the following:

From the insurance policy	From the third party line of credit/loan (if utilized)
Your client is protected with the valuable insurance protection that they need.	The cash value of the policy is used as collateral for a loan, usually in the form of a line of credit that can provide a source of supplemental tax-free funds for the borrower.
Premiums into the policy grow on a tax-deferred basis (up to the maximum allowed under the Income Tax Act), reducing your client's income tax bill.	Depending on the agreement with the lender, the principal and interest payments may be capitalized or serviced through additional borrowing. Therefore, no payments to service the loan may be required before death, at which time it is paid using the tax-free proceeds from the Death Benefit.
The amount of the Death Benefit net of the loan is paid to the your client's named beneficiaries tax-free.	The interest expense may be a deductible expense if the proceeds of the loan are used to earn income. However, you should consult with your team of professionals to ensure that this is feasible for your client's specific situation as well as what amount can be deducted.

Is The BMO Insurance Insured Retirement Plan Right for Your Clients?

When considering whether to suggest The BMO Insurance Insured Retirement Plan to any of your clients, you may want to run through the following checklist to determine if the plan is appropriate for their individual needs:

- Does your client require permanent insurance?
- Will the proposed lives insured qualify for insurance?
- Has he/she maximized their RRSP and TFSA contributions?
- Would he/she like to transfer a portion of their taxable investment portfolio into a tax-deferred investment vehicle?
- Does he/she want to lower their personal income tax bill?
- Does he/she require more retirement income than what they anticipate getting from their RRSP/RRIF?
- Is your client comfortable with carrying debt?

If your client answers "yes" to these questions, then The BMO Insurance Insured Retirement Plan may be an ideal solution for them.

Tax Considerations

The information contained in this section is general in nature and should not be construed as legal or tax advice. The comments are provided as discussion points only for you and your client to review with their team of professionals including legal and tax experts.

Interest Expense Deduction

If the funds are borrowed personally using the policy as collateral and the proceeds of the loan are invested to earn income, the interest may be deductible from the borrower's taxable income. The ability to deduct interest expense on a loan has been recently scrutinized by the Canada Revenue Agency (CRA). Your client's legal, tax and accounting advisors should determine whether this is feasible for their individual circumstance. The Collateral Insurance Deduction is not available for third party leveraging situations. Interest deductibility is not available if the funds are used for personal life style purposes.

Taxation of Bank Loans

General Anti-Avoidance Rules (GAAR) prohibit financial transactions that are generated solely for the purpose of creating tax benefits. Using the BMO Insurance Insured Retirement Plan and based on the current interpretation of the Canadian Income Tax Act, the income from a bank loan should be received tax-free by the recipient. However, CRA could apply GAAR rules to the third party loan and consider the amount to be a policy loan. This result would mean that a portion (or all) of the loan amount would be taxed as income. Your clients should be aware that this risk exists, but also that the Agency accepts the fact that taxpayers should be allowed to structure their affairs in an efficient manner.

In addition, it is important when proposing the BMO Insurance Insured Retirement Plan to your clients that the life insurance established be a key requirement.

Other Considerations

When proposing the BMO Insurance Insured Retirement Plan, you and your clients should consider the following:

Longevity risk
Be conservative with the projected values on the illustration you present to your clients. If your client outlives the projection, additional collateral security may be required to continue to capitalize the loan or draw additional amounts to fund the interest costs. Alternatively, the policy may have to be surrendered for its cash value to get the loan back within acceptable lending limits. This latter option would mean a taxable disposition and tax would need to be paid by the policy owner.

Rates earned on the life insurance cash and loan not connected
The growth of the cash value is independent of the accumulated balance of the loan and the interest rate charged on the loan is negotiated between your client and their lender. The lending institution advancing the loans will monitor the policy's cash value to ensure that it is sufficient to pay-off the outstanding loan balance, but you should also check to make sure that your client's objectives are still on track. In-force illustrations may be a good tool to monitor this progress.

Case Study

Client Details:

For example, consider Max and Marie who are both 45 years old. They've both been maximizing their RRSP contributions and are planning to retire at age 65. They also have another mutual fund portfolio set aside for retirement, but it's being taxed annually. Working with their advisor, they discover that they can save an extra $15,000 per year and need $380,000 of permanent life insurance protection. They'd like a cost effective and tax efficient plan that helps them achieve all of their goals.

At age 65, Max and Marie are able to secure a loan from a lender using the cash value of their policy as collateral for a loan. This permits them to borrow up to an amount equal to 90% of their cash value.

The Solution: The BMO Insurance Insured Retirement Plan

Comparison of Values

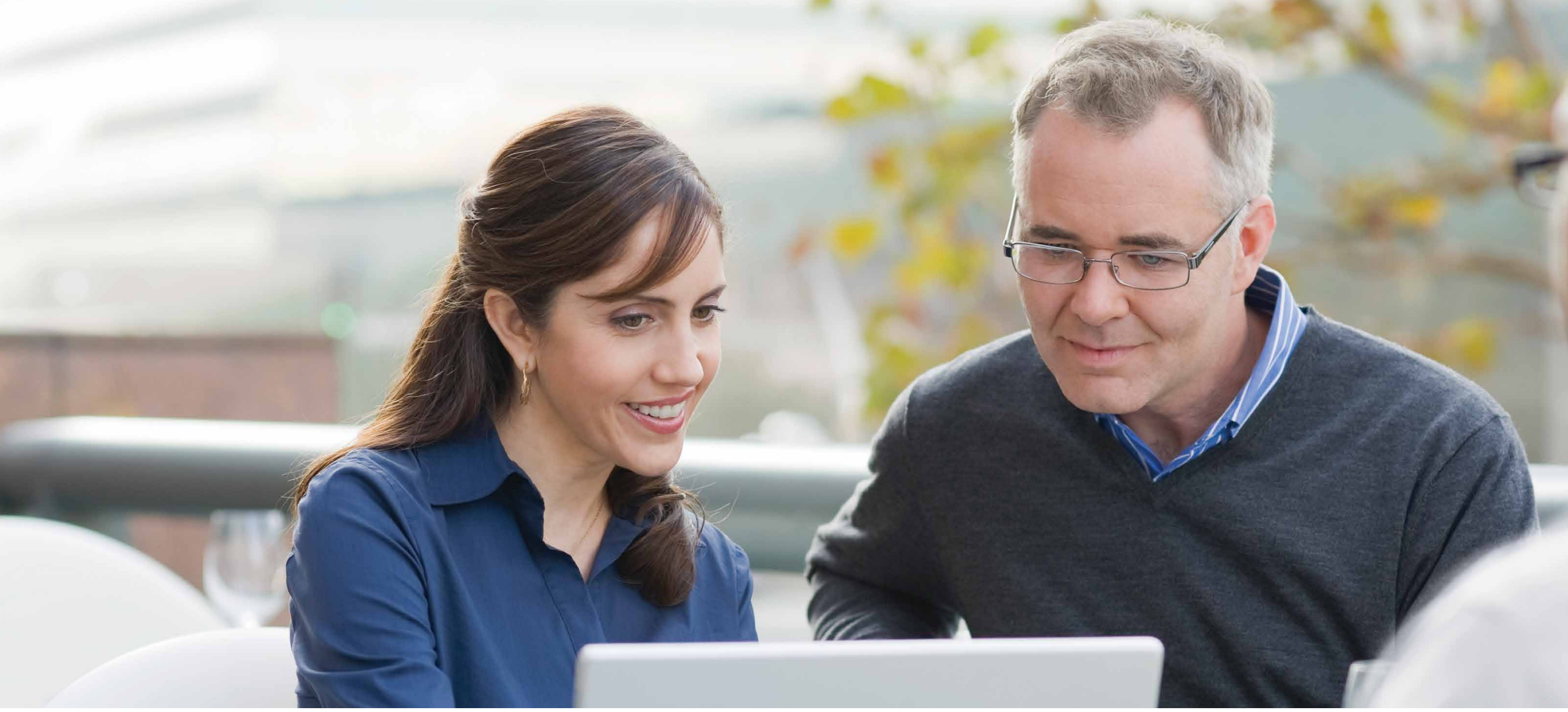
	BMO Insurance Whole Life Plan	Traditional Taxable Investment Portfolio^
Annual Deposit (for 10 years)	$15,000	$15,000
Rate of Return	4.50%	5.00%
Projected After-tax income (starting from ages 65 to 85)	$16,280	$16,280
Initial Life Insurance Coverage	$384,023	$0
Gross Estate Value (at age 85)	$985,246	$0
Loan Balance (at age 85) (at 5.50% per year)	$592,950	$0
Net Estate Value (at age 85) (after loan and taxes)	$392,295	$0

The Results, using The BMO Insurance Insured Retirement Plan

- Max and Marie now have a tax effective retirement savings plan – beyond their RRSP and TFSA.
- The investment component of the policy accumulates on a tax-deferred basis.
- When they retire, they can use the cash value of their plan as collateral for a third party loan (or line of credit); the proceeds of the loan can be used as a source of tax-free retirement income.
- The outstanding balance of the loan is paid-off from the tax-free proceeds of their life insurance policy; any residual amount is then paid to their named beneficiary.

Note: This example is based on a BMO Insurance Whole Life Estate Protector (The Wave v45.0) policy and is merely a projection of future results, using a set of assumptions that will change over time. Actual results are not guaranteed and will vary. This projection is not complete unless it is accompanied by all of the pages of an illustration from the Wave illustration software. Loans are subject to the terms of third party lenders. BMO Life Assurance Company does not guarantee the availability of such loans or that your clients will qualify for them.

^Assuming a Balanced Fund that has the following income: 50% interest, 30% dividends, 10% unrealized capital gains and 10% realized capital gains; individual dividend tax rate: 38%; personal tax rate: 50%; probate fees: 1.5%.



Underwriting and Administration Considerations

When proposing the BMO Insurance Insured Retirement Plan, you should consider the following:

- Check to ensure that the amount of insurance you are proposing on any life is reasonable and justifiable; this amount will need to be approved by a BMO Insurance Underwriter.
- Refer to BMO Insurance's Underwriting Guidelines found under the *Underwriting Guidelines* menu of our Wave software for details on age, amount and financial underwriting requirements.
- Run a personalized illustration for your client, using the latest version of the Wave illustration software and include a signed copy with the application.
- To ensure that the Underwriter reviewing the application for insurance understands the purpose of the insurance, include a covering letter with a summary of what is being proposed.

Frequently Asked Questions

The information contained in this section is general in nature and should not be construed as legal, tax, or lending advice. The comments are provided as discussion points only for your client to review with their professionals advisors including legal and tax experts as well as lending professionals.

Q1

When presenting the BMO Insurance Insured Retirement Plan, what are some of the risks that should be discussed with your client?

i. Interest rate spread:
The spread between the interest credited within the policy versus the interest rate charged on the bank loan is key and should be set conservatively given the long term nature of the plan. Although the absolute rates of interest on the two products are certain to differ from those illustrated, as long as the spread doesn't change much, the solution shouldn't be drastically impacted by such changes. Ideally, multiple illustrations should be run to demonstrate to your client the impact of such fluctuations in rates.

ii. Outliving projection:
The possibility (and consequences) of the insured outliving the projected values (i.e. the year the projected loan to CSV ratio exceeds the lender's lending limit in the illustration) could mean that additional security would need to be pledged for the loan or repayments may be required to get back within lending limits. This typically happens at later years when a client's ability to come up with additional values or funds is limited. You should always project hitting the maximum loan to cash value ratio several years beyond expected mortality to reduce this risk.

iii. Interest deductibility:
The interest expense on borrowed funds may not be deductible or may get so large that insufficient taxable income is available to take advantage of the deduction. Even if income is sufficient to absorb the tax deductions you and your clients should evaluate whether those deductions will still be at the assumed marginal tax rate.

iv. Loan availability:
There are no assurances that loans will be available in the future when the client is expected to access them. In addition, most lenders have minimum loan amounts that must be met before considering a lending program that involves their life insurance policy. So, be sure that the projected annual loan amounts meet the lenders minimum requirements.

v. Tax risks:
As mentioned in this guide, GAAR implications should be considered and reviewed with a professional tax consultant before implementing this plan.

Q2

What are some of the bank lending considerations that you and your client should be aware of?

The insurance values are only one criteria that the lender evaluates during their underwriting process. A full lending application will be required to demonstrate the client's credit worthiness and that this plan is part of a balanced financial strategy. To determine if your client is suitable, the lender will look at such metrics as debt servicing ratios, net worth ratios, and credit reports in addition to the illustration (which must be based on reasonable assumptions).

Lenders typically request the following information during the application process:

- Purpose of requested financing and amounts
- Net worth statement on the lender's prescribed form
- Three years of income tax returns
- Policy illustration (may request several scenarios using different assumptions)
- Insurance policy details

When the loan is approved, and before advances are made, the following additional information may be required:

- Original copy of the insurance policy
- Acknowledgement letter from the client confirming that the lender:
    - Has made no representations with respect to specific tax outcomes
    - Has no liability for any taxes payable by your client and that may result from their participation in the arrangement
- Confirmation from the insurer:
    - That the assignment in the bank's favour has been implemented and they have the only claim to the cash value and death benefit proceeds
    - The current cash value
    - Of the policy details such as current owner, insured, beneficiary, that policy changes will be restricted and that no policy loans are outstanding nor will any be advanced after the assignment

Q3

How much will the lender advance against the policy values?

Advances are limited to a portion of the cash value available. Depending on the type of policy and underlying investment risk, the advances can range from 50% to 100% of the cash value. Lenders tend to accept a maximum loan to cash value ratio of 90% to 100% on whole life plans. For universal life plans, the typical range is 50% to 90% depending on the underlying investment options selected by the client on the UL policy. Fixed income options like GICs or BMO Insurance's Guaranteed Market Indexed Account (GMIA) tend to be at the higher end of the range whereas equity linked investment options would be at the lower end of the range. Clients may want to be a little more aggressive with their investment options up to the point they decide to leverage the policy and then switch over to fixed income options as required to maximize lending limits. BMO Insurance's Wave illustration software allows this type of transfer to be projected easily. The lender will determine the loan to cash value ratio for each specific case and is not bound by the examples suggested in this response.

The credit limit on the loan typically reflects the clients requested advances over the next five years. So if the client needed $100,000 for five years, the lending vehicle would be set at $500,000. The $500,000 lending limit is what would typically be compared to the lender's minimum requirements to determine if they would participate in the arrangement.

Q4

Is it safe to assume that the bank will allow the client to capitalize the loan interest?

Banks don't tend to allow capitalization of interest on these types of loans as it impacts their ability to recognize income on the loans (they become non-performing loans). Instead, they prefer that clients either pay the interest each year or borrow additional amounts to cover interest costs each year.

Appendix

RRSP Deduction Limit

Your RRSP deduction limit is calculated using the previous year's earned income. This means that your 2019 RRSP contribution room will be based on your 2018 earned income.

The sources of income that qualify as earned income include:

a) net employment and business income
b) disability payments from the Canada Pension Plan or the Quebec Pension Plan
c) royalties
d) net rental income
e) taxable alimony and separation allowances received
f) net research grants
g) employee profit sharing plan allocations
h) supplementary unemployment benefit plan payments

Items that reduce earned income include:

- net rental losses
- alimony or separation allowances paid
- union or professional dues
- employment expenses

The easiest way to find your RRSP contribution room (or as Canada Revenue Agency [CRA] calls it, your deduction limit) is to look it up on the Notice of Assessment that CRA sends you after you file your annual income tax return. If you would like to verify the amount CRA says you may contribute to your RRSP, here's how to calculate it for yourself.

For 2019, your RRSP deduction limit is calculated by adding any RRSP deduction room you carried forward from 2018 to the lesser of $26,500 or 18% of your 2018 earned income.

If you are a member of a Deferred Profit Sharing Plan (DPSP) or Registered Pension Plan (RPP), you have one and possibly two more steps. You must deduct your pension adjustment (PA) and if you have a net past service pension adjustment (PSPA), you must also deduct that amount.

Let’s connect

To find out more about BMO Insurance products, please call your MGA, contact the BMO Insurance regional sales office in your area or call 1-877-742-5244.

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