WESTWARD ADVISORS

WHAT'S ON THE HORIZON FOR
LEVEL COST INSURANCE?

THE ISSUE

Has the LCOI ship already set sail? Level cost insurance (LCOI) was once one of the most attractive life insurance products on the market for those who intended to keep the coverage for life. Rates were low when averaged over a lifetime, making it an ideal option for an insurance-based estate plan. Recently, though, LCOI has undergone a sea change.

After a decade long price freeze, the cost is going up and up. More changes are in store. RBC has decided to scuttle its popular Term 100 and Universal Life products. Industrial Alliance and Manulife haven't abandoned ship - just yet - but both companies are raising the price of their LCOI products to keep them sustainable in an unstable market.

This Viewpoint examines the recent changes to LCOI products, whether they'll remain a viable solution…and for how long.

The opinions expressed in this memorandum are strictly those of Westward Advisors Ltd. This memorandum is for information purposes only and is not legal or tax advice.

The Discovery Process™ The Strategy Builder™ The Strategic Implementor™ The Performance Optimizer™ The LifeStep Process™

WESTWARD'S VIEWPOINT

What's the advantage of LCOI?

LCOI and YRT (yearly renewable term) are the two methods of pricing universal life insurance. LCOI is a fixed or "level" cost of insurance for life. YRT is a cost of insurance that increases each year for life. LCOI costs more than YRT in the early years and significantly less in later years. It is therefore wise to select LCOI if one intends to maintain coverage for life and to avoid the possibility of premiums escalating in one's retirement years.

The benefit of LCOI is further improved when a policyholder assigns the policy as collateral for an investment loan under an Investment Credit Facility ("ICF") issued by the insurance company. This creates two advantages:

1. The internal rate of return calculation on almost any LCOI insurance policy produces an **annual pre-tax return of about 10%** on the LCOI payments in exchange for the tax-free death benefit measured over a typical life expectancy.
2. The ICF offers the potential to add **lifetime personal tax recovery**, further increasing the overall rate of return produced by the insurance structure.

What's in store for level cost Insurance products?

Insurance companies claim that LCOI has been significantly underpriced for years, forcing them to make tough decisions on the future of these products. RBC took new LCOI-based policies (Term 100 and Universal Life) off the production line as of June 23. Industrial Alliance and Manulife aren't making such a drastic move, but with recent rate increases of 8.0% and 6% respectively, it makes you wonder whether their products may soon be priced out of the market. Here's how some LCOI rates have increased over the past 18 months:

Manulife LCOI Rate Increases[1]	IA LCOI Rate Increases[2]
December 2010 – 10%	January 2011 – 10%
October 2011 – 9%	December 2011– 16%
June 2012 – 6%	July 2012 – 8%

Is there a window of opportunity?

The price of level cost insurance is increasing largely because of historically low interest rates. Other forces are also at work. The March 2012 Federal Budget proposes changes that could increase income tax paid by the insurance companies on level cost products. This is likely to send the price even higher, and may result in more LCOI vendors taking their offerings off the shelf, just like RBC.

Canadians have been able to take advantage of LCOI long after insurance companies in other countries have terminated similar products. The window of opportunity may be closing, but it hasn't slammed shut. We recommend the following courses of action for those who hold level cost products or are in the process of applying for one.

- **Think hard if you are considering cancelling.** As noted, the advantages are significant, particularly if you have crossed the magic line and the premiums are now much less than they would be under a YRT plan.
- **Do not delay if you are in the market for LCOI.** Manulife's rate increase is already in effect, but IA will accept applications until July 13. There are bound to be further price increases and product withdrawals down the road, so get in if you still can.
- **Younger applicants should discuss the pros and cons with an advisor.** The recent rate increases are aimed at early age applicants. If you miss the application deadline, it's still worthwhile to compare YRT and LCOI based strategies to see if locking in the current rates before they go up again provides long-term advantages.

[1] *Increases are averages quoted by Manulife for their Innovision product.*
[2] *Increases are averages quoted by Industrial Alliance for their Genesis product.*