

2013 BUDGET :: 10/8 SURRENDER CHARGES PUNISH SOME WESTWARD CLIENTS PROTECTED FROM FINANCIAL HARDSHIP



THE ISSUE

The March 21st Budget proposals may force borrowers under 10/8 arrangements to repay their loans before January 1, 2014. Despite the Budget's proposal to allow tax-free withdrawals of policy cash values during 2013 to help borrowers repay 10/8 loans, there are some borrowers who will suffer financial hardship as a consequence of the Budget's proposals.

This Viewpoint discusses one possible cause of financial hardship: **policy surrender charges**. It also explains how Westward clients are protected from this financial hardship.

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WESTWARD'S VIEWPOINT

10/8 arrangements are structured such that the loan balance plus accrued interest at any time is less than the cash value of the policy that secures the loan.

Some 10/8 loans are secured by universal life insurance policies with surrender charges applicable to the policy cash values. Based on the strength of the borrower's credit rating, the borrower qualified to draw a loan advance equal to the policy cash value before applicable surrender charges.

Surrender charges are typically a percentage of the cash withdrawals taken from a policy, if withdrawals are made in the first eight to ten years from the policy issue date. The insurer will deduct the surrender charge when paying the cash from the policy.

Westward clients are protected from paying surrender charges if forced to repay loans with policy cash values.

In a 10/8 arrangement, withdrawing cash from the policy to repay the loan will incur surrender charges if applicable under the terms of the policy contract. To avoid any applicable surrender charges, the borrower will have to repay the entire loan with funds from outside the policy.

Thus, 10/8 arrangements subject to surrender charges will cause financial hardship if the borrower cannot repay the loan balance plus accrued interest with funds from outside the policy. Such a borrower will either:

- Suffer the cost of the surrender charge to pay down the loan with policy cash
- Suffer denied interest deductions for continuing the loan under the new Budget rules

Westward Clients Unaffected by Surrender Charges

The situation described above is not applicable to Westward clients because all Westward clients with 10/8 arrangements use policies without surrender charges. If it becomes necessary for Westward clients to repay loans from policy cash values later in 2013, there will not be any erosion of cash values on account of policy surrender charges. All cash values equal or exceed the related loan balances.

Nevertheless, the financial hardship that surrender charges will cause to holders of some 10/8 arrangements is just one example of why the Budget proposals should grandfather existing 10/8 arrangements in place on the March 21st Budget date.

Grandfathering existing life insurance arrangements when introducing taxation changes has been a typical approach in the past because of the financial hardship inherent in unwinding life insurance structures. Even this Budget includes a provision to grandfather existing life insured annuities from the new life insured annuity rules. Why were 10/8s overlooked? Hopefully, further consultations will cause Finance to see the justification for grandfathering existing 10/8 arrangements on account of the financial hardships that will affect some taxpayers as a result of complying with these punitive changes.

