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A window of opportunity

The rules governing how much tax-free cash a client can hold in a permanent life policy are changing. But advisors who act now may be able to help their clients benefit from the existing rules for years to come

By Megan Harman | Mid-October 2015

Clients hoping to use their permanent life insurance policies as vehicles for accumulating tax-sheltered savings soon will face tighter restrictions on how much tax-free cash they can hold in those policies.

But, until these rules, known as the "exempt test," are changed in January 2017, there's an opportunity for financial advisors to help their clients take advantage of the existing rules. Because policies purchased prior to the changes will be grandfathered, the benefits of acting now may extend far into the future. Specifically, wealthier clients with the means to overfund their policies by putting more cash into them than is required to cover the premiums may want to consider doing so before the changes come into force.

Notes Asher Tward, vice president of estate planning with TriDelta Financial Partners Inc. in Toronto: "There's a big opportunity for advisors to push these strategies prior to the changes. It might be an opportunity to tell clients that the rules are changing, so if they want to consider it, now is the time."

You also should urge your clients who are considering making changes to their in-force life insurance policies to do so prior to 2017, as certain changes made after that could subject those policyholders to the new rules.

Time will be of the essence. "There's a great planning opportunity right now - a short window for those people who are looking to grow their money on a tax-free basis," says Mark Halpern, certified financial planner, trust and estate practitioner, and president of WEALTHinsurance.com and illnessPROTECTION.com, in Markham, Ont.

The relevant changes to the Income Tax Act set out how much of the investment earnings associated with the cash value in a life insurance policy are exempt from taxes. The exempt test rules have allowed many affluent policyholders to shelter substantial sums within their policies, a result the government did not intend. The aim of the changes is to end this practice by reducing the tax-exempt savings room in permanent life insurance policies. There also will be fewer options for clients to pay up their policies over an extremely short period of time.

"The new exempt test is going to limit the amount of money that can be put into these policies," says Halpern. "[The overfunding strategy] is not going to be as attractive as it is right now."

Universal life (UL) policies will be affected most significantly by the new rules, and certain types of life policies, as they're currently structured, will no longer be viable. Kingston, Ont.-based Empire Life Insurance Co., for example, announced in late June that it would close one of its UL products to new sales, partly due to the tax legislation changes and partly due to low interest rates that have made the product's investment guarantees unsustainable. That product, called Trilogy Plus, had various investment account options for policyholders that were specifically designed for the existing exempt test rules, says Mike Stocks, vice president, insurance marketing, with Empire Life.

"We wouldn't have been able to continue that product as of January 2017, and because of the sustained low interest rate environment, it just didn't make viable sense for us to continue it for a year, then just discontinue it," says Stocks. "So, we made the decision to pull it a little bit more than a year before we would need to."

He says Empire Life is designing a new UL product that will be feasible under the new rules to replace Trilogy Plus.

Toronto-based Manulife Financial Corp. also has taken steps to tweak its policies in advance of the new rules. When Manulife introduced a new line of UL products in 2014, the company made some adjustments to account for the new rules, initially slated to take effect in January 2016.

After the government postponed implementation of the new rules to 2017, Manulife decided to restore certain elements of its UL product (MUL) temporarily to conform with the previous tax structure, which allows clients to take advantage of the rules until the changes take effect.

"The new MUL had moved to position itself in advance of the [exempt test] change. But with the delay, we decided that we were missing out on too many sales opportunities," says David Baker, assistant vice president, insurance products, retail markets, with Manulife. "So, we reverted to the current practice."

Halpern suspects that all insurers will take steps to assess and adjust their products prior to 2017. "I don't think any company will not be affected by it," he says.

As clients learn about the changes, Baker says, the result could be an uptick in permanent life insurance sales in the months to come: "The exempt test changes, I expect, will drive more sales this year."