What you need to know about the New Insurance Leveraging Rules

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There is a lot of talk about the new rules on leveraging insurance contracts; in fact, you may have received questions from clients whose advisors are proposing the strategy. As you will know from a couple of my past emails, I have always been cautious on the leveraging strategy, formerly known as 10/8. It was my experience there could be serious practical issues if used in the wrong situations. In my opinion all four of the criteria below should be met before the strategy is considered.

1. The client should have stable high income - no anticipated swings from high to low (or zero).

2. An astute client - knowledgeable, reasonable, detail-oriented - must understand the strategy.

3. Strong professional advice - the strategy will require expert ongoing service and advice.

4. There must be a clear permanent life insurance need - this should go without saying but I have seen several instances where the strategy was used for tax advantage only.

Following much awaited changes to the act contained in the 2013 budget, the design of this strategy is now in accordance with the legislation passed last fall.

The interest rates in use are now “market” based; this was the primary concern CRA had with the 10/8. Currently rates are approximately 6.25% for the loan and 4.6% - 4.75% for the investment portion. These are higher than money market rates because they are a blend of commercial paper, mortgages, equity gains and long term real estate investments. The returns are “smoothed” by spreading results over a period of years so there is a certain stability built into the return.

The potential tax savings are lower than 10/8 but this is a good thing as the long term interest deductions had the potential to “super size” the loans in the former 10/8 plans.

In the right circumstances, the new leveraging strategy can be quite helpful to clients who require a long term insurance solution but who also have a strong capital need to finance their business.