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What's going on with Term to 100 (Universal Life) and why is it so important for Professional Advisors to understand ?

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Recently Manulife announced that Universal Life and Term to 100 (level cost of insurance products) were going up from 8% to 20% at certain ages. Older ages (+ 70) were not so affected. These increases were official as of December 4, 2010.

This was a surprise to many advisors and there was some concern this might have had something to do with the reserve issues Manulife dealt with in 2009. The fact is, however, that as an industry, level cost of insurance products have been under-priced for many years and because of current low interest rates here in Canada with no sign of significant increases coming, the problem is getting more serious.

Life insurance in its simplest form is a bond with an uncertain maturity – hence the insurance factor. But it is interest rates which largely determine the pricing of the annual contributions / premiums required to fund the ultimate maturity. In 2009, John McKay (of PPI Financial), a highly regarded actuary, one of whose key roles is product design, wrote an article in which he stated that the pricing of level cost products had not changed materially since early 2000, when yield rates for long-term Government of Canada Bonds were approximately 6.3%. Given the significant drop in yield rates on such bonds over the intervening years, the pricing of level cost products was hard pressed to be sustainable.

From early 2000 until late 2010, these bond yields have dropped to approximately 3.5%, almost by 3%. And what has happened to insurance rates in that time ? Industry averages are calculated to have decreased by roughly 6% for a male, age 50 - instead of increasing by 35 – 50% - an approximation of what was actuarially required to offset the interest rate reduction.

RBC Insurance increased their "level cost of insurance" rates (U.L./T100) early in 2010. Manulife followed December 4, 2010, as noted. We believe the other major carriers will follow soon or risk putting a ton of new business on the books at a price that cannot be reconciled with reality.

But what happens next ? The International Financial Reporting Standards (IFRS) to which Canada's financial system is committed will result in full disclosure and repercussions for companies who are under-reserving and under-pricing products. What has been largely "in house" until now, will have wider publication and potential impact on financial statements, share prices and, in fact, operations of insurers.

The bottom line is that unless interest rates rise significantly in the next two or three years, the cost of Universal Life/Term to 100 products – and even some annual mortality charge type plans - will increase significantly. It has already been announced that Canada Life, Sun Life, Empire Life and Industrial Alliance will all be increasing their rates.

In fact, Transamerica pulled its level cost insurance (LCOI) products in 2010 and two weeks ago RBC Life announced a similar change to their portfolio of products.

The advantage of fixed level cost mortality charges is that a large secure financial institution guarantees to charge a set mortality rate for a very long time – perhaps 30, 40 or even 50 years or more. (Whole Life participating plans are not directly affected because they do not offer those guarantees – the company charges whatever it needs year by year).

It is important for professional advisors of all disciplines to be knowledgeable on this important matter. An insurer's covenant is what stands behind every insurance contract. Whether a company fails or not is one question; another is how much worry will our clients tolerate as their insurance contracts age and mature over the next several decades, through good times and bad, high interest rates and low?

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Further, there are companies with excellent covenants who have not yet made adjustments but will. Rising insurance rates is never a good reason to buy life insurance, but where there is a clear need that will result from planning being done today, it may make sense to "warehouse" coverage in advance in order to lock in the current rates.

As professional insurance advisors, we take our role very seriously and will work with our clients and their tax and planning advisors to select well priced products from excellent insurers.