



In July 2010, a new regulation passed by the government came into force that removed the tax exemption previously being received by insurers on life insurance policies. The insurance industry predicted increases in premiums by 15% – 25% over the next five years claiming the cost of this change is too much for the industry alone to absorb.

Many insurers used this tax change as a rationale for advisers to recommend clients shift some or all of their life insurance from **Term** Policies (sometimes known as Yearly Renewable Term, YRT or Rate for Age) to **Level** Premium Policies. The rationale behind this was that it would enable clients to 'lock-in' a price prior to 1st July and therefore not be affected by the forecasted increases to premiums from the tax changes.

Why the Tax change?

Current tax rules date from the time when life insurance policies contained a considerable savings component. The rules were set assuming those policies would collect savings, and the interest on those would be taxed. With the switch to term life policies by most insurance companies since the mid-1990s, those newer policies have effectively been under taxed.

The tax changes only applied to Life insurance policies. Income Protection, Permanent Disablement, Trauma, Disability Key Person and Medical Insurance policies were unaffected.

The government has given the life insurance companies a 'grandfathering' period on all life insurance policies in force as at 30th June 2010, reducing the immediate tax impact on existing life policies. For all Term policies this is expected to be up to five years; for Level premium policies it is up until the end of the term of the contract.

How the Insurance Companies actually responded

There has been large variation from the insurers as to the extent that they actually increased Life insurance premiums. Some did nothing at all, others increased premiums by 15%, but the majority applied very modest increases of 5%-7%. Others held off implementing increases until October. The most significant changes were to Level Premium policies. Recently one insurer has actually reduced their Term Life Cover premiums.

But irrespective of the increases (or reductions) any insurer actually imposed, most insurers (Tower being the exception as they don't have a level life premium contract) have reported significant uplift in new premium in the June/July months and acknowledge that it was a consequence of the conversion of existing Term life policies to Level premium.

Level versus Term Policies

The principle behind Level Premium Life Insurance in simple terms is that the cost is spread 'equally' over the lifetime of the policy to avoid paying a very high cost in later years.

However, what Level Premium policies also mean is that in a person's younger years when the need for cover is likely to be highest, they will pay anything up to three times the actual cost of the insurance as compared to a Term policy. Triplejump adheres to the philosophy that we should minimise the cost of transfer (insurance)

but without ignoring financial risks that a client cannot retain. In the long term our clients are better off, if by keeping the cost of insurance down they can increase their net wealth through debt reduction or wealth accumulation.

The marketing material for Level policies suggest that the breakeven point is at the age when the Term premium equals the Level premium and thereafter you are 'in the money' if having insured with a Level premium policy. Typically the marketing graphs show this cross over point at about 10-12 years after the policy has been put in place.

However, these graphical illustrations do not take into account the opportunity cost of clients paying substantially more in the early years. Depending on the client's situation, this cost of capital could range from lost opportunity to invest and grow wealth through to lost opportunity to reduce debt at a faster rate and therefore save interest.

Triplejump created a range of scenarios and developed spreadsheets to analyse the 'true' breakeven point using a hypothetical scenario for a client with a mortgage and another for a client who was debt free and could save 'surpluses'. Our findings showed that if in the first 11 years of comparison, if a client with a \$300,000 table mortgage applied \$200 per month of the difference in premium between Level and Term to reducing their mortgage, they would pay off their mortgage 4 years earlier and save \$72,000 in interest. If the client had no debt and saved \$200 per month in addition to their current KiwiSaver scheme at an average return of 2.5% pa net, they would accumulate additional savings of \$35,000.

Using the cumulative opportunity cost comparison it took **22-24 years before the client was 'in the money'** provided they held the policy for that duration. If the client dies 'too soon' that is before that breakeven point then they have paid more for their cover than they needed to.

There are claims from insurers that the persistency of Level policies is better than Term policies; however there is little real evidence to support this. Consumers are frequently sold Level policies for the long term benefits but as a consequence are 'unsold' those benefits before capitalising on them for the lure of cheaper premiums.

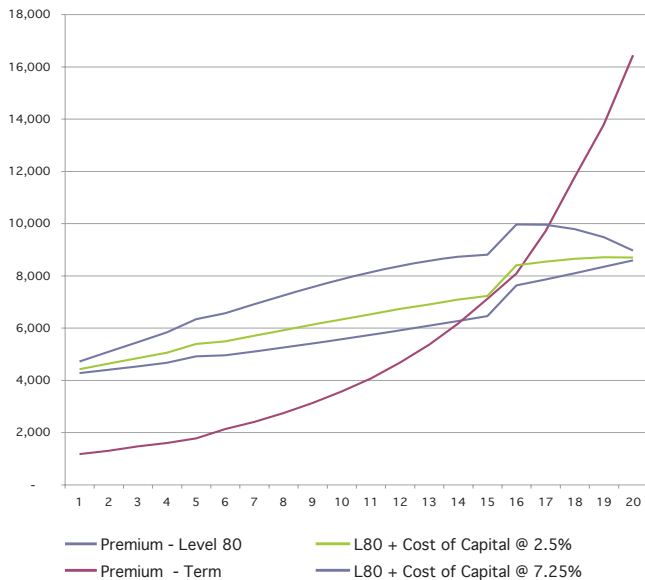
We know also that most clients have only a limited amount of money that can be spent on insurance. If they are paying three times as much for life cover, the chances are they will be forced to make choices not to insure other important risks such as loss of income from disablement, or major medical expenses.

Both Level and Term policies may have a place to play in a risk portfolio, but appropriate analysis of how these products fit with a client's need to grow and protect wealth is reliant on (central to) best advice.

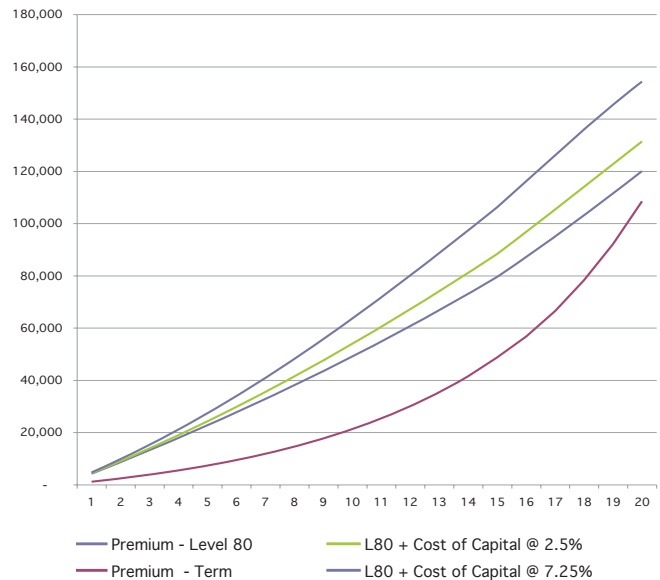
as life happens



Term vs. Level 80



Term vs. Level – Cumulative Cost



Advice for your clients

There are always risks for clients when they cancel existing policies and replace them with alternatives. Benefits that have accrued over time (such as cover for suicide) may be lost and clients may omit to disclose (albeit unintentionally) material information about changes to their health.

If your clients have been advised to switch to Level premiums or to switch to another insurer to get lower Term rates, it is important they understand the consequences and the risks of such choices, and

consider all the relevant facts that affect their needs and objectives. If you observe that your client's life premiums have substantially increased then it may be because of a switch to Level premium. Your client may have done this without fully understanding the long term costs.

Triplejump can provide a full appraisal of the best structure for your clients taking into account the long term opportunity costs and the long term objectives to ensure that they are making informed decisions about their insurance needs.

Triplejump launches Guidelines and Templates for Buy and Sell Arrangements

A significant part of the advice Triplejump provides to its clients relates to the Buy and Sell requirements of shares in closely held companies between shareholders.

Triplejump advocates that the business owners properly document their intentions through a Buy and Sell deed. We also advocate that if insurance is being used to fund the purchase price then the policies are held in a Trustee Company.

We have been aware for some time that many legal firms have not had access to guidelines and templates to assist in constructing Buy and Sell deeds and especially where insurance is implemented and the ownership is a Trustee company.

Triplejump has engaged the services of John Brown LLB, and author of CHH Trusts and Estates, to develop guides and templates that we can make available to legal advisers to support the drafting of Buy and Sell deeds.

We will provide further information regarding these templates in our next newsletter. The tools available are:

- A Buy and Sell deed questionnaire for the Business Owners
- A Buy and Sell deed Guideline for Legal Advisers
- A Trustee Ownership guideline
- A template for the client instruction to the Trustees
- An Interim Declaration of Trust template

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