

GREENBERG

WEXLER

&
EIG, LLC

4600 East West Highway, Suite 975
Bethesda, MD 20814
www.gwellc.com
O: 240-644-6735

Fundamentals of Life Insurance Planning For Private Wealth

Mid Atlantic Fellows Institute
American College of Trust and Estate Council
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1. Insurance Overview
2. Planning for Private Wealth
3. ILIT's and ILIT Funding
4. Life Settlements
5. Policy Valuation
6. Summary

- What is Insurance
 - The transfer of risk for consideration

Term life insurance

- Temporary - *if* you die coverage
- Stated death benefit, duration and premium
 - Durations are from 1 year to 40 years depending on age
- Hedging strategy
- It bridges the gap between now and when other Private Wealth is accumulated or realized

Permanent life insurance

- *When* you die coverage
- Asset Class
- The need to deliver dollars in the future never goes away

- **Conversion provision – very important !**
 - Convert to permanent policy without new medical evidence
 - Varies from company to company
 - The longer the better
 - Some company's limit conversion policy options
 - This is becoming more and more popular
 - The conversion provision affects policy pricing
 - Shorter conversion periods result in lower costs
 - Limited product options result in lower costs
 - Choose companies with a long conversion provision and a solid permanent life portfolio available for conversion, otherwise you may be stuck with an inferior product upon conversion

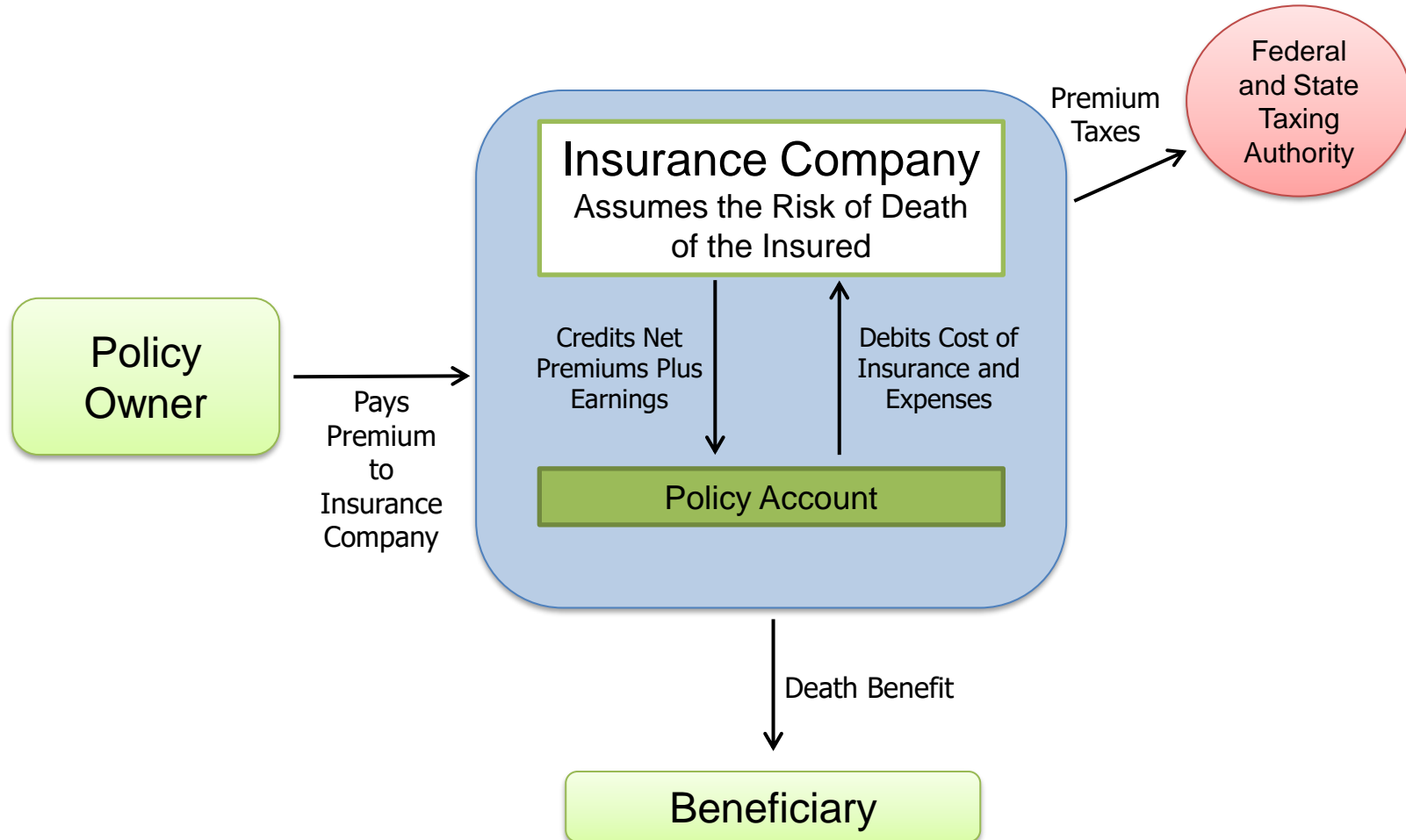
Permanent Life Insurance: Forms

- **Whole life insurance**
 - Black Box
 - Guaranteed Premium Cash Value and Death Benefit
 - Eligible for Dividends
 - Expensive but may be worth it

- **Universal life insurance**
 - One platform
 - Six different policy forms
 - The difference is in how premiums are invested and credited to the policy
 - First understand the platform
 - Then understand the investments and the risks

- Either can be issued as (1) individual coverage or (2) second-to-die coverage
- The death benefit can be level, or it can increase

Universal Life Insurance Platform



Policy Form Earnings Risk Spectrum

**MORE POLICY OWNER GUARANTEES
LESS UPSIDE POTENTIAL
LEAST MARKET RISK**

**LESS POLICY-OWNER GUARANTEES
MORE UPSIDE POTENTIAL
MOST MARKET RISK**

Term
Insurance

NLG-UL

Whole Life
and CA-UL

Equity Index
UL

Variable
UL

Private
Placement
VUL



IC = Mortality Risk
PO = 0 Risk Premium
Guaranteed Death Benefit
Guaranteed

IC = Mortality Risk
PO = 0 Risk Premium
Stipulated DB Guar
not to lapse
Must pay premiums on time

IC = Mortality Risk
PO = General Account
Performance Bond risk w/o
Mark to Market

IC = Morality Risk
PO = Index Performance
Min Floor
Max Ceiling
Less downside Than VUL, More
Upside Than WL and CAUL

IC = Mortality Risk
PO = Sub acct risk, no min
No max
Equity risk
With asset Allocation
Opportunity

IC = Mortality Risk
PO = Sub acct risk, no min
No max
Equity risk
Includes Hedge funds
Accredited Investors

Life Insurance Planning Overview

- It's a process:
- What is the purpose of the coverage?
- What's the right amount?
- What's the right duration?
- What is the right owner/beneficiary arrangement?
- What is the owner's premium payment and investment risk tolerance?
- What is the right premium financing strategy
- Can we get the contract underwritten? Underwriting Advocacy
- It appears simple and it's deceptively complicated

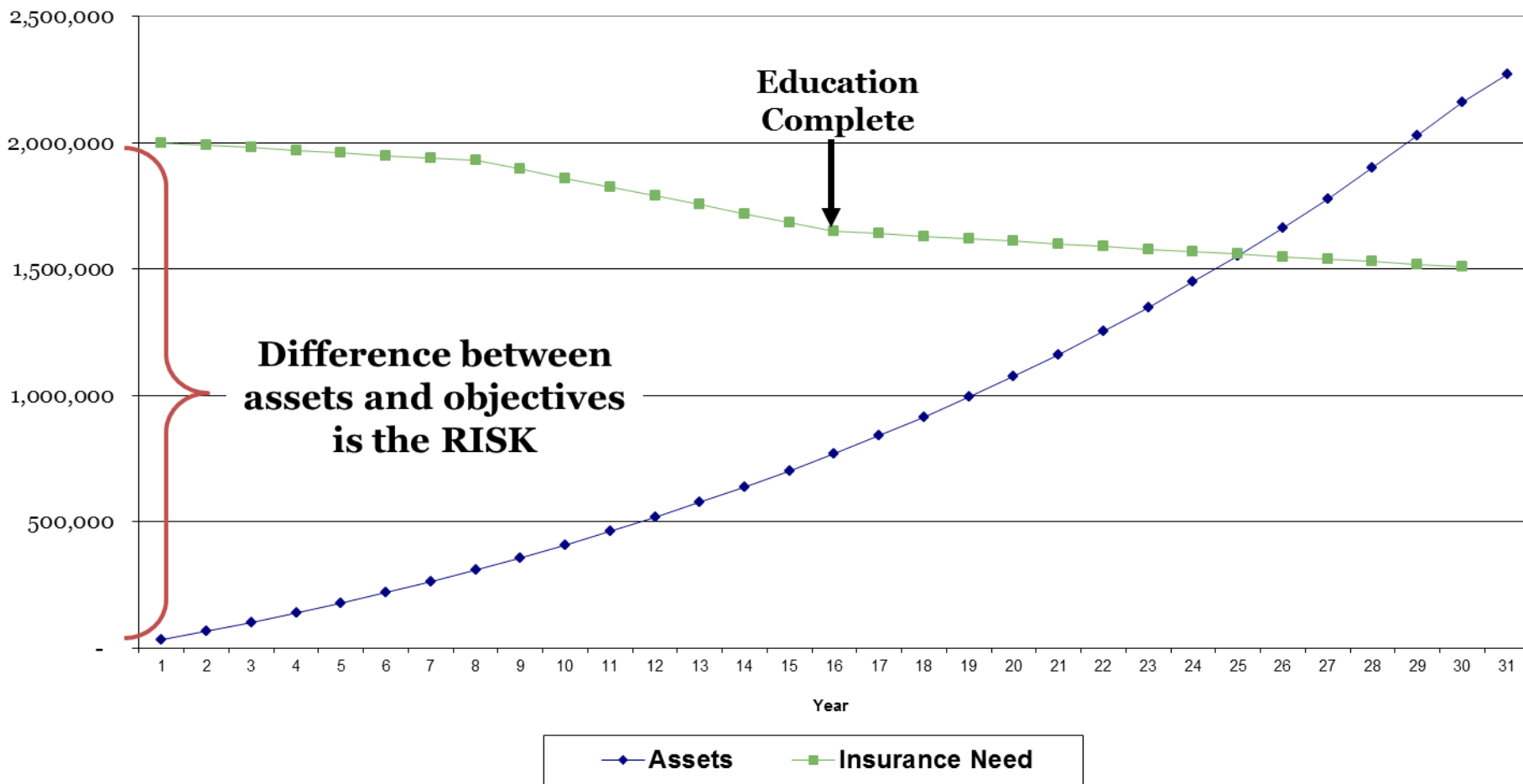
Life Insurance Planning Applications

- Risk Management/Family Financial Security
 - Traditional/Divorce/Pre-Post Nuptial Planning/Blended Families/Special Needs Families/Non-Traditional/International
- Risk Management/Business Succession/Business Financial Security
- Estate Planning – Trust Owned Life Insurance (TOLI)
- Executive Benefit Funding

Family Financial Security

- Creates an immediate estate for the benefit of the family
 - Pays off debts
 - Pays for final expenses
 - Funds education
 - Funds survivor income
- In theory, debts get paid off, children get educated and retirement, as well as other savings, reduce the need to create an immediate estate
- What is the best policy form for this type of planning?
 - Temporary Coverage/Hedging Strategy
- Exceptions
 - Special needs children
 - Charitable bequests

Filling the Risk Gap



Other Family Financial Security Issues

- Divorce
 - Loss of the unlimited marital deduction
 - Matching support payments with death benefit
 - What is the right owner/beneficiary arrangement?
- Pre/Post Nuptial Planning
 - In Trust or Out of Trust?
- Blended Families
 - Life Insurance can keep the peace
- Special Needs Families
 - Special needs trusts
- Non-Citizen Families
 - Permanent Residents
 - Non Resident Non Citizen
 - Q-DOT or Cross Ownership?
- Non-Traditional

- Estate planning
 - Liquidity for estate taxes
 - Blended Family/Legacy Planning for family or charity
 - Wealth replacement combined with a CRUT
 - Dynasty Trust asset class income tax mitigation using a non-correlated asset class
 - Estate/Business equalization
 - SLAT survivor funding
 - Time Hedge for other estate planning strategies
- Is the death benefit needed if I die or when I die?
 - Is this a Hedge or and Asset?
- Insure one life or two?

- Succession Planning, Key Person Planning, Loan Collateralization
 - Cross Purchase Agreement
 - Business Redemption Agreement
 - Hybrid Agreement
 - Insurance LLC
- Life insurance is the financing tool for the liability created by the business or agreement
 - Is this a hedge until the business is sold?
 - Is this an asset that finances the business succession or the estate tax?
- Corporate Owned Life Insurance (COLI) hazards
 - 101(j) Compliance
 - Corporate Alternative Minimum Tax for C-Corporations was eliminated in the Tax Reduction and Jobs Act of 2017

Policy Acquisition and Contract Formation

- Ok, buying life insurance makes sense
- Now what do I do?
- It's a process

- Offer, acceptance, consideration
 - Application by the policy owner (offer)
 - Completion of the insurance medical exam and other underwriting requirements
 - Underwriting by the insurer
 - Accept, decline, counter-offer
 - Contract issued by the insurer (acceptance)
 - The policy is delivered to the policy owner
 - Premium tendered by the policy owner (consideration)
 - Contract is formed and coverage is in force

- Medical Information
 - Exam/Medical History Questionnaire
 - Medical Records and Physician Statements
- Hazardous Activities and Avocations
- Financial Information
- Motor Vehicle History
- Travel History
- Telephone Interview
- Capacity and Re-insurance
- Covid and Accelerated Underwriting

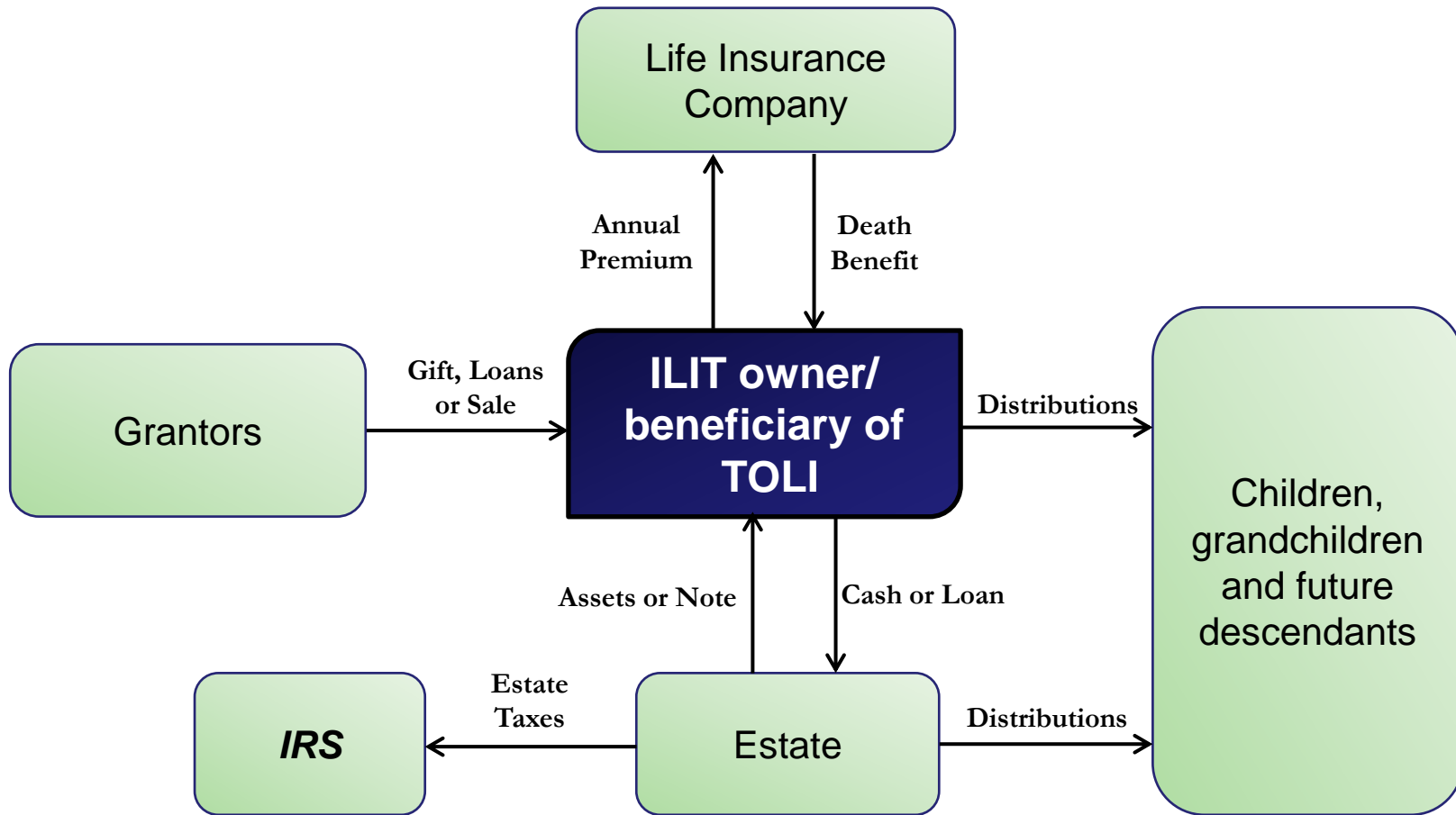
ILITs and ILIT Funding

- What is an ILIT
- Characteristics of Trust Owned Life Insurance
- The Trust Funding Hierarchy and how they work

What is an ILIT

- Irrevocable Life Insurance Trust
- It is a fiduciary arrangement that allows a third party (the Trustee) to hold assets on behalf of a beneficiary or beneficiaries
- Legal document
- Non-natural entity
- Empty receptacle until it is filled up

Irrevocable Life Insurance Trust (ILIT) Trust Owned Life Insurance (TOLI)



Characteristics of TOLI as an Asset Class

- Matures for cash
- Income tax free death benefit
 - The inevitable gain of the death benefit over premiums is like step up in basis of estate assets at death
- Estate and/or GSTT tax free depending on the trust
- Defer income tax on increased values for
 - Dividends, interest and ST/LT gains on trades
 - Portfolio rebalancing
- Reduces the gift that keeps on costing
- Income tax free basis withdrawal
- Income tax free loans
- Income tax free loan repayment from the death benefit
- Significant return in the event of an early death
- Attractive long-term returns compared to assets of comparable risk at life expectancy
- Guaranteed Contacts eliminate investment risk of certain asset classes
- Shifts uncertain market volatility risk to certain mortality risk
- TOLI can buy the time required for the other tax planning techniques to work

Trust Funding Hierarchy

1. Annual Gifts- Crummey Notice
2. Lifetime Gifts – Gift Tax Return
3. Personal Loans at the AFR
4. Business Loans
5. Sale to an intentionally Defective Grantor Trust (IDGT) (Gift and Loan Combination)
6. GRAT Remainderman
7. Value Realizing Event (Sale or IPO) of a gifted asset
8. Commercial Financing
 1. Margin Loans
 2. Commercial Bank Relationship Loans
 3. Specialty Finance Company Loans
 4. Bond Financing (Variable Rate Bond Obligation VRBO)

- Annual Gifts
- Lifetime Gifts
- Split Gifts
- Annual exclusion = \$15,000/donor per donee/year
- Lifetime exclusion = \$11,700,000/donor,
\$23,400,000/couple,
- Reverts to \$5,850,000 per person plus inflation in 2026

Modified Endowment Contract

- What happens if I pay one premium?
 - It changes the income tax treatment of the cash value
- Death Benefit is always Income Tax Free
- Cash value grows income tax deferred
- Withdrawals taxable first
- Loans are taxable
- 10% penalty if withdrawn before 59.5
- What happens if the policy is owned by a non-natural person?

Personal Loans/Split Dollar

- Private and Compensatory Loans (Split Dollar)
- Non-Loan Endorsement or No Equity Regime gets economic benefit treatment per Revenue Ruling 66-1110
- Loan or Equity Regime gets AFR loan treatment or Section 7872 treatment
- Short Term Blended, Mid-Term, Long-Term
Applicable Federal Rate

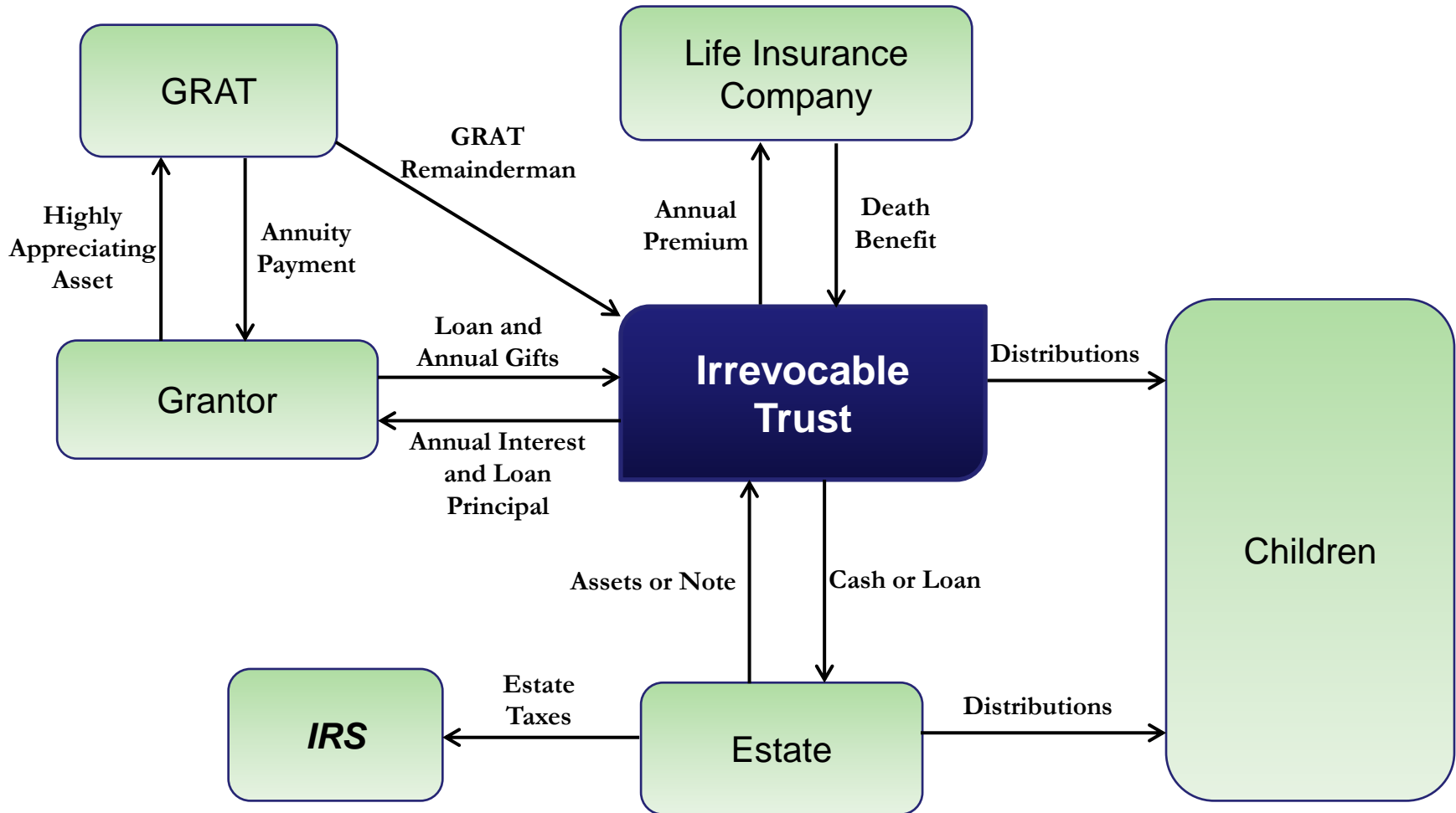
Private Split Dollar

- Grantor Loans
- Grantor's Spouse Loans
- Loans from existing ILITs or Dynasty Trusts
- Pay loan interest
- Accrue loan interest
- Loan from the grantor is included in the estate
- Low interest rates
- No renewal or re-underwriting risk
- One loan or annual loans
 - Annual loans are a new loan with the interest rate at the time
- Put the IRS on notice

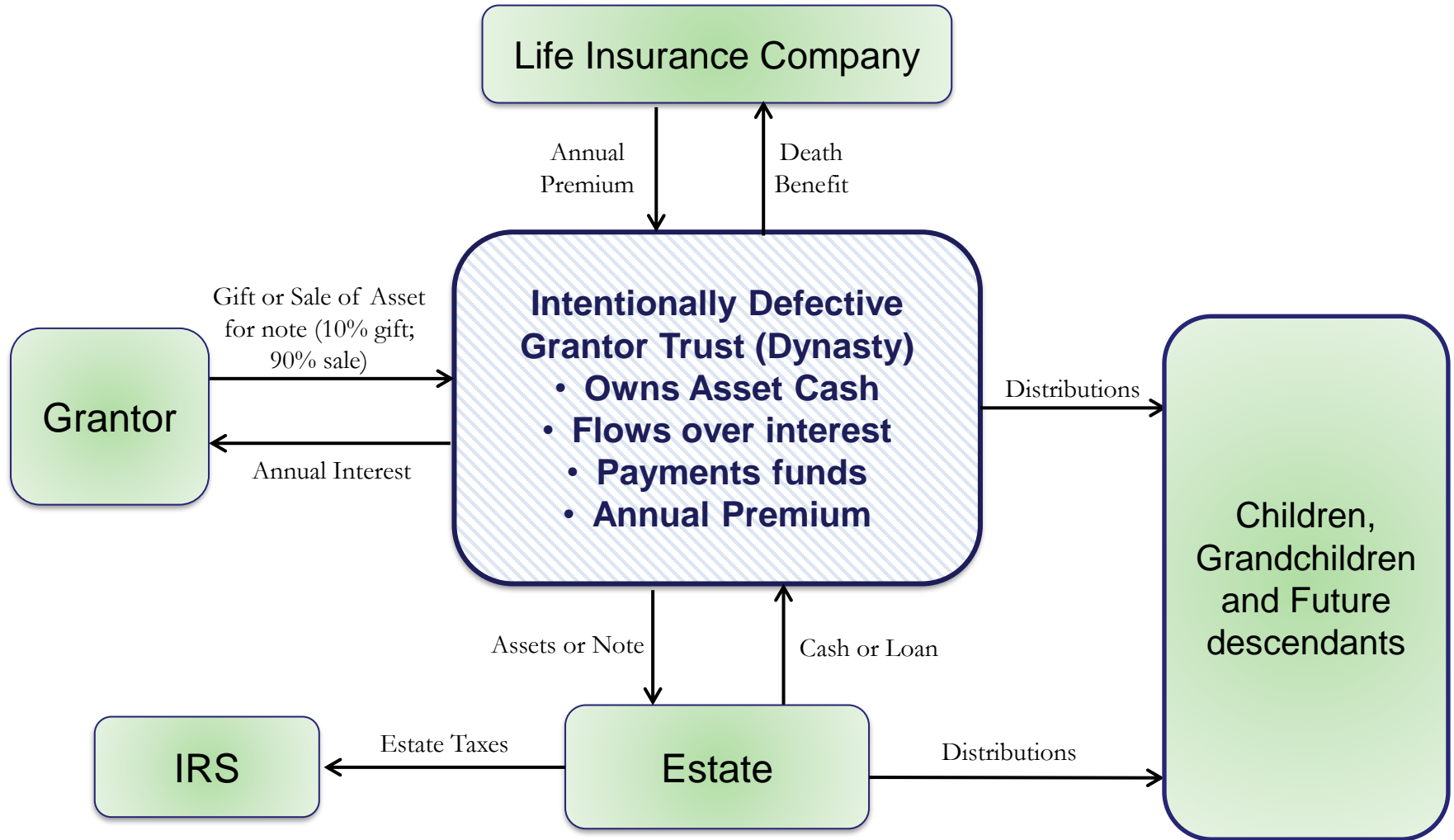
- Commercial Loans
 - Bank Loans
 - LIBOR plus points
 - Requires collateral
 - Usually requires skin in the game
 - More expensive
 - Preserves liquidity
 - Limited policy selection
 - Lender renewal/re-underwriting risk
- Margin loans
 - ⑩ Limited to 50% of the account value
 - ⑩ The account is the collateral
 - ⑩ Less expensive, more volatile
- What is the Exit Strategy?

- Life Time Gifts
- GRAT Remainderman
- Sale to IDGT
 - Discounted high appreciation potential
- Policy Loans and Withdrawals
- VRE Proceeds
- Existing Trust Assets
- Death is not an exit strategy
- Combining Gifts and Loans
- Interest Only with Balloon Payment

Gifts, Loans & a GRAT



Sale to an IDGT



IDGT Arbitrage Analysis

*Trust Owned Life Insurance Premium Funding Strategy
Sale to an Intentionally Defective Grantor Trust
Arbitrage Analysis*

Property	5,000,000	5,000,000
Discount	20%	30%
Value	4,000,000	3,500,000
Gift 10%	400,000	350,000
Loan	3,600,000	3,150,000
Long Term AFR	2.08%	2.08%
Net Cash Flow Assumption	7.00%	7.00%
Cash Flow Amount	350,000	350,000
First Year Loan Interest Payment	74,880	65,520
Net Trust Cash Flow	275,120	284,480
Annual Premium	103,905	103,905

What happens if a policy is no longer:

- ✗ needed
- ✗ wanted,
- ✗ affordable and

and the policy owner is going to get rid of the policy?

1. Terminate the contract

- Collect the cash surrender value
- Gains are taxable as ordinary income
- Policies with large loans may result in phantom income

2. Stop paying premiums

- A UL-policy might lapse before death
- Whole life policies have a non-forfeiture options
 - Reduced Paid up policy
 - Extended Term Policy

Policy Termination Alternatives

3. Sell the policy in the institutionally funded secondary market for more than the cash value and less than the death benefit

- Over age 70, possibly 65
- \$1,000,000 minimum
- Cash value less than 20% of death benefit
- Ongoing premium 5% of less than the death benefit
- Policy issued at preferred underwriting
- Change in health
- Life expectancy 15 years or less
- Universal Life mostly
- Convertible Term Insurance
- Variable Life is a securities transaction

Life Settlement Example

- Male, age 72
- \$1,500,000 term policy
- Pre-cancerous



Policy settled for \$150,000

- Recent changes due to the Tax Cut and Jobs Act of 2017
- Revenue Ruling 2009-13 is repealed
 - Basis = premiums paid
 - Cash value in excess of premiums taxable at ordinary income
 - Excess subject to capital gains
 - Term insurance is all capital gain

Life Settlements

- Closing documents are worse than a real estate closing
- Many parties to the transaction
- Hire a broker – have them shop the market
- Think of this as an appraisal – if the price is right the juice is worth the squeeze
- If someone is willing to pay a high price for a policy, it might be a good investment for the family

- Valuation events
 - Gift of policy to a new trust
 - Sale of a policy from trust to trust
 - Policy Value included in the estate
 - Owner pre-deceases insured
 - Compensatory distribution
 - Transfer to and from business
 - Life settlement sale

- Gift and estate value
 - Fair Market Value – willing buyer/seller
 - Secondary Market Value – depends on age and health
 - Interpolated terminal reserve (ITR) may be more than cumulative premium
 - Get a 712 quote before requesting for estate or gift return
 - Different insurance companies use valuation methods

- Compensatory value
 - Fair Market Value
 - Greater of ITR or PERC (Premiums plus earnings less Reasonable Charges)

- Interpolated Terminal Reserve (ITR)
 - Guidance is outdated
 - Designed for whole life policies
 - What does reserve mean?
 - Cash Surrender Value
 - Statutory Reserve with deficiency
 - Statutory Reserve without deficiency

Life Insurance Policy Valuation Examples

Carrier	Policy Type	Face Amount	Value Reported by Carrier	Valuation Method
A	NLG	\$5,000,000	\$941,803	AG 38 Statutory Reserve (with deficiency)
B	NLG	\$5,000,000	\$237,930	Cash Surrender Value
C	NLG	\$5,000,000	\$512,389	AG 38 Tax Reserve (without deficiency)

Summary

- More important to have the right amount than the right kind
- Temporary needs = term insurance=Hedge
- Permanent needs = permanent insurance=Asset
- The best policy is not necessarily the policy with the lowest premium
- Understanding the income and transfer tax issues of the client, trust and life insurance is critical in the design of a Private Wealth Plan
- Planning, policy selection and acquisition is a process
- You need to know enough to ask the right questions
- Find an insurance professional that you can rely on

Questions

David A. Wexler, CLU, ChFC, AEP
Greenberg, Wexler & Eig, LLC
4600 East West Highway Suite 875
Bethesda, MD 20184
240-644-6735 (O)
202-345-5578 (M)
[dwexler@gwellc.com](mailto:dwxler@gwellc.com)
www.gwellc.com

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