THE LIFE INSURANCE GOES RIGHT HERE

UNDERSTANDING HOW LIFE INSURANCE FITS YOUR PRACTICE

Eric Eklund, Esq., Senior Director of Advanced Planning | Jones Lowry

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DISCLAIMER

Jones Lowry reviews, designs, implements, and manages life insurance programs for high-net-worth clients and their advisors.

Jones Lowry does not practice law or accounting and does not manage investments.

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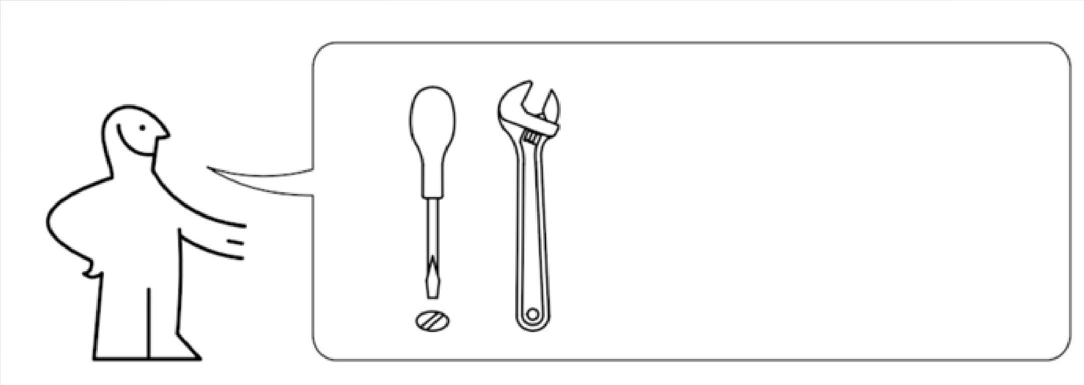
EVALUATING LIFE INSURANCE TRANSACTIONS

STARTS LIKE THIS….



BUT OFTEN ENDS UP LIKE THIS…

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Innovative Life Insurance Solutions

WOULDN'T IT BE NICE IF LIFE INSURANCE CAME WITH SIMPLE INSTRUCTIONS?

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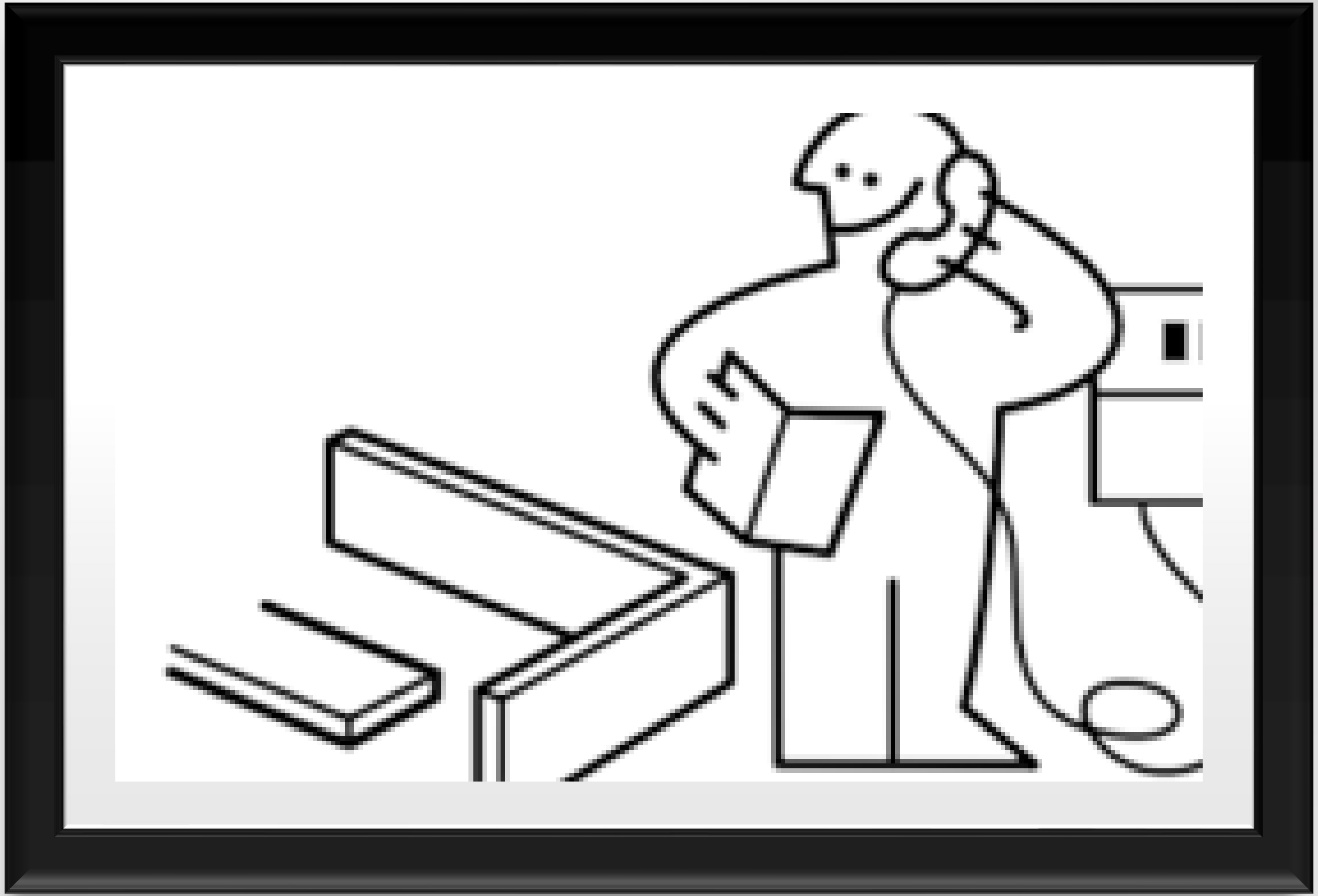
THAT'S WHY YOU NEED TO CALL … THE LIFE INSURANCE ADVISOR




BUT BEFORE YOU DO . . .

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TODAY WE ARE GOING TO LEARN…

- Learn why life insurance is good property.
- Have a quick tour of the primary types of life insurance.
- Learn 9 common planning scenarios where life insurance is the right tool and where to put it.
- Share common ways your client's can pay for the insurance.
- Discuss how you can these concepts **into your own practice to add value** to your clients.

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LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

The life insurance policy is a contractual promise to pay a defined death benefit at the insured's death.

LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

The policy premiums buy a future benefit with discounted dollars.

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LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

In nearly all circumstances, the death benefit is paid income tax free. IRC § 101(a).

LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

Life insurance underwrites time, it underwrites tomorrow. Life Insurance guarantees the money to pay the bills if the time runs out to earn the money to pay the bills.

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PERMANENT
LIFE INSURANCE
IS GOOD
PROPERTY
BECAUSE…

Permanent, or cash value life insurance policies include a cash value component that:

- Grows income tax deferred;
- Can be accessed income tax free;
- For any reason!

IRC §72 & §1012

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LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

The rights and responsibilities of policy ownership can be contractually shared among multiple parties.

LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

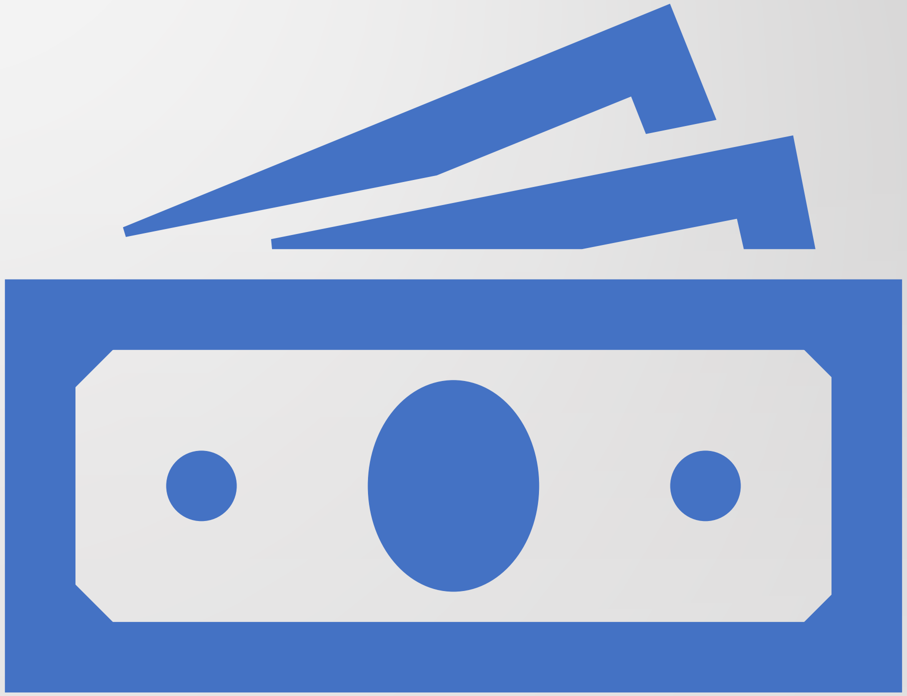
Modern policies incorporate other benefits or “living benefits” into the policy such as:

- Disability Waiver of Premium
- Chronic Care Benefits
- Long-Term Care Benefits

LIFE INSURANCE IS GOOD PROPERTY BECAUSE…

It not only creates assets, it protects them.

In most states life insurance policy death benefits and cash values receive a degree of creditor protection.



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FLA. STAT. 222.14 PROTECTS BOTH POLICY OWNERS AND BENEFICIARIES

Exemption of cash surrender value of life insurance policies and annuity contracts from legal process.—The cash surrender values of life insurance policies issued upon the lives of citizens or residents of the state and the proceeds of annuity contracts issued to citizens or residents of the state, upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor of the person whose life is so insured or of any creditor of the person who is the beneficiary of such annuity contract, unless the insurance policy or annuity contract was effected for the benefit of such creditor.

http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&Search_String=&URL=0200-0299/0222/Sections/0222.14.html

LIFE INSURANCE "101"

THE BASICS OF WHAT YOU MUST KNOW TO ADVISE ON A LIFE INSURANCE TRANSACTION

“TYPES” OF LIFE INSURANCE

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Term Life Insurance:

- Term life insurance pays the policy face amount if the insured dies during the policy term.
  - 10, 20, 30-year term…
- At the end of the term the policy expires with no additional value.
- To the life insurance carrier, the policy is pure risk. Because there is no cash value component, the entire policy death benefit is considered “net amount at risk,” or NAR meaning that the annual costs of insurance are based upon the total policy death benefit.
- Based upon actuarial tables, the costs of insurance (and thus premiums) increase year over year. But these costs can be averaged resulting in fixed level premiums over the term period. (10 year, 20 year)

“TYPES” OF LIFE INSURANCE

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Cash Value Life Insurance (AKA – Permanent Life Insurance):

- In a cash value life insurance policy, the contract includes a cash value component that accumulates funds available to the policy owner.
- The cash value acts as a personal reserve towards the life insurance death benefit and an investment vehicle to accumulate more money to offset future costs of insurance.
- The remainder of the difference between the death benefit and the cash value is the “Net Amount at Risk” or “NAR”. This NAR determines the annual insurance charges coming out of the policy.

THE SEVERAL "FLAVORS" OF PERMANENT INSURANCE

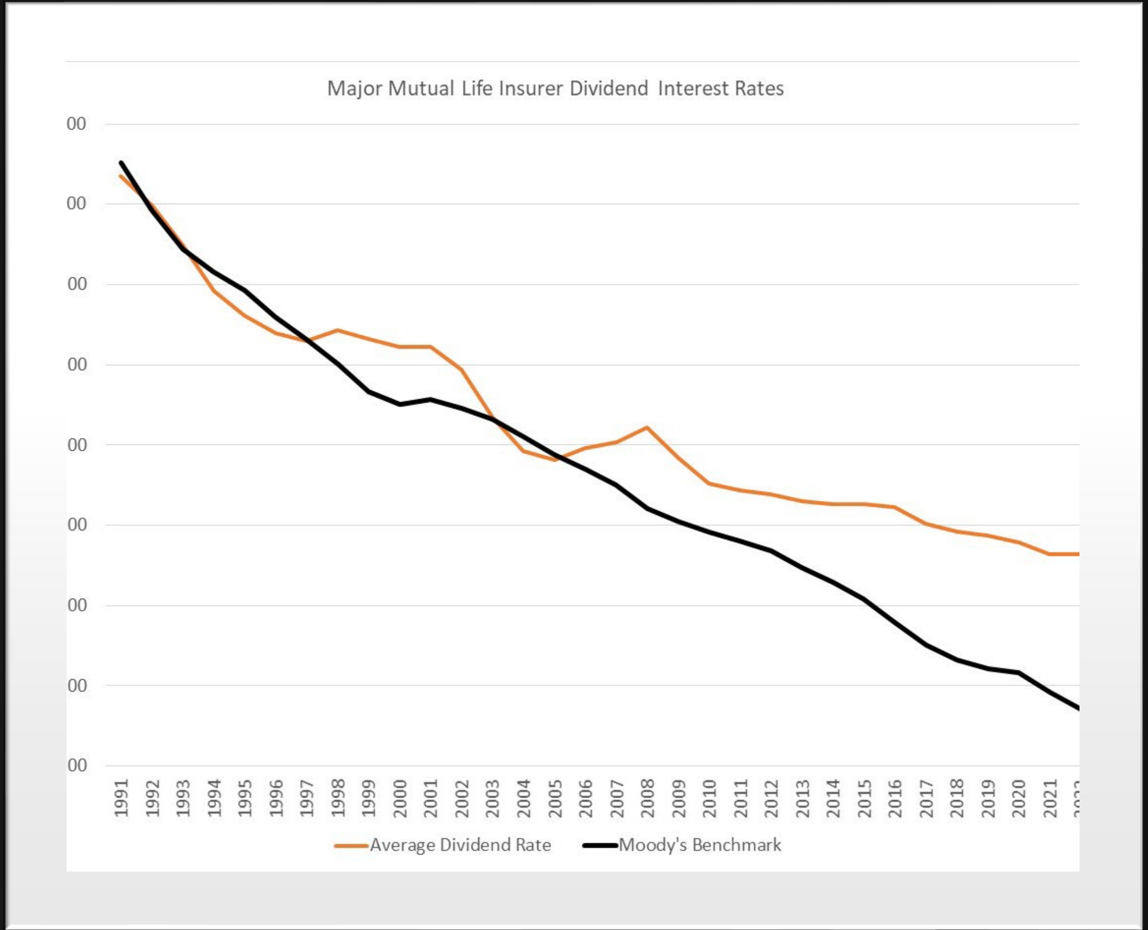
- **Whole Life**
- **Limited Pay – Whole Life**
- **Universal Life**
  - **General Account**
  - **No-Lapse**
  - **Indexed**
  - **Variable**
    - **Private Placement**

WHOLE LIFE INSURANCE

- Insurance carrier bears all the investment risk.
- Premiums are directly related to the amount of insurance bought;
- Premiums must be paid when due, or the policy will lapse;
- Premiums are calculated to create sufficient cash reserves to cover policy costs over the insureds entire lifetime – presently age 121.
- While generally designed to pay premiums every year a policy may be designed to be guaranteed "paid-up" in a shorter duration – i.e. "10-Pay" or "pay to 65."
- In profitable years, the Insurance carrier may pay non-guaranteed dividends (returns of premium) to the insured which the policy owner may use to buy additional "paid-up" life insurance, reduce premiums, accumulated or paid out the owner as cash, or purchase extended term insurance.

2022 WHOLE LIFE AVERAGE DIVIDEND RATES

- Source: M Financial Group



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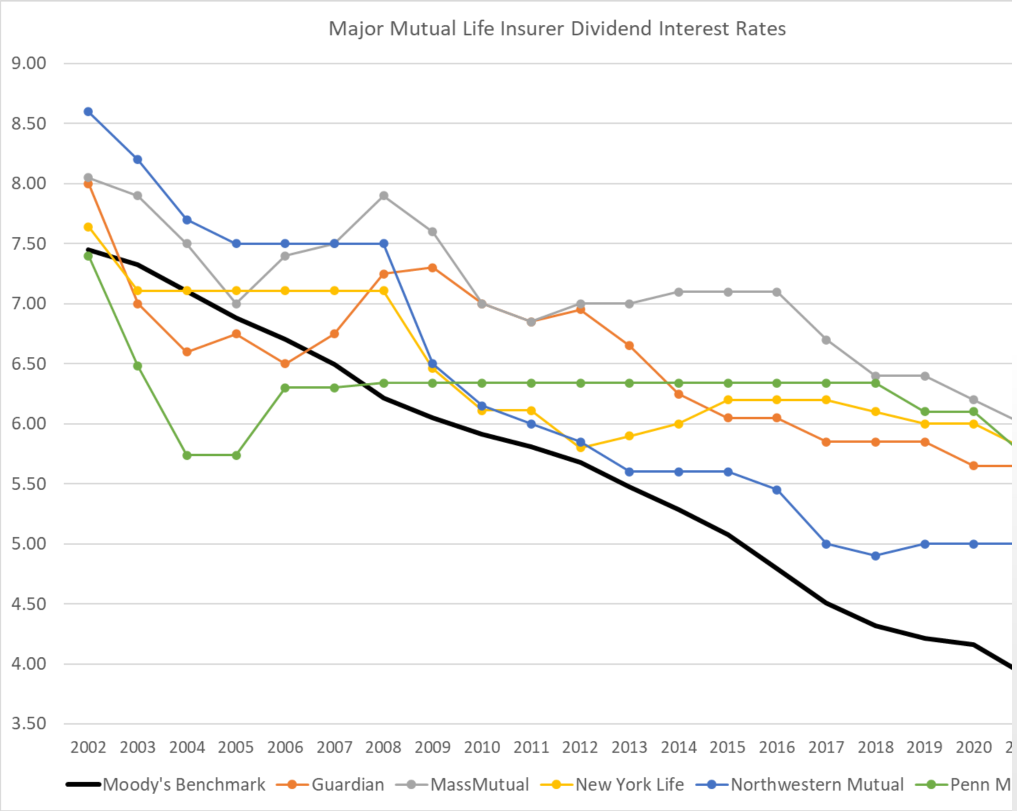
2022 WHOLE LIFE INSURANCE DIVIDENDS

- Source: M Financial Group



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UNIVERSAL LIFE INSURANCE

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- Many different "flavors" of Universal life insurance (UL)
- But generally –
  - Adjustable death benefit contracts (can easily be adjusted down, adjustment up may require additional underwriting)
  - Flexible premium payments
  - Policy charges are unbundled
  - Flexible Platform – the policy holder controls the premium payments and controls the cash value build up in the policy.
- Ultimately a universal life policy can mimic a term policy or a whole life policy but with greater flexibility.

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"FLAVORS" OF UNIVERSAL LIFE INSURANCE

- **General Account UL (UL)**: The insurance company is responsible for investing the cash value and providing a current or guaranteed stated rate of return to the policyholder.
- **No-Lapse Guarantee (NLG):** Ensures policy will not lapse prior to a certain age or life so long as minimum premiums are paid. Guarantee that policy will pay during the no-lapse period even if cash value drops to zero.
- **Equity Indexed (IUL):** A general account product that gives the policy owner an option to tie their cash value returns to a given index such as the S&P 500 subject to certain caps and floors. The insurance company invests the policy cash value in options contracts and structured notes to achieve the returns. May include an additional cost or load.
- **Variable (VUL):** VUL policies allow the policy owner to invest in any number of investment accounts offered by the insurance carrier and offer separate account protection.

MORE ON VARIABLE UNIVERSAL LIFE INSURANCE

- **Variable (VUL):** VUL policies allow the policy owner to invest in any number of investment accounts and offer separate account protection in the event of carrier insolvency. The products themselves are considered securities and can only be sold and serviced by registered representatives. VUL generally shifts the investment risk to the policy owner and servicing producer.
- **Private Placement VUL:** Similar to VUL, the private placement component allows qualified buyers the opportunity invest in non-registered investment funds inside the policy. Due to the "qualified buyer" requirements – generally this is only suitable for wealthy clients, businesses, and institutions.

SECOND TO DIE

A VARIATION ON A THEME

TWO INSUREDS COVERED BY ONE POLICY

- In the modern life insurance market, the only policies ensuring more than one life are second to die policies.
- The policies pay a death benefit at the second death of the two insureds.
- Premiums are often lower in 2nd to die coverage due to the low probability of both insureds dying each year, and reasonable actuarial expectations that the combined life expectancies of two lives is greater than one life.

CHOOSING THE “TYPE” OR “FLAVOR” OF INSURANCE

WHAT ARE THE FACTORS MY CLIENTS SHOULD BE CONSIDERING?

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FIRST – CHOOSING BETWEEN TERM AND PERMANENT LIFE INSURANCE

- Term Coverage:
  - Generally, the lowest outlay option for life insurance coverage.
  - Good alterative for short-term or defined needs (mortgages, divorce settlements, buy/sell or key person coverage).
- Permanent Coverage:
  - Designed for long term retention.
  - Good alternative when the policy owner can benefit from cash accumulation, income tax deferral, and income tax savings due to the tax favor provided to life insurance.
  - Good choice when there is a deferred need for capital such as saving for future investment, share repurchase, employee compensation plans.

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SECOND – CHOOSING BETWEEN PERMANENT LIFE INSURANCE "FLAVORS"

- Whole life provides more conservative clients with a guaranteed death benefit combined with a cash value that grows over time to equal the face value of the policy.
  - Fixed and level premiums for life of the insured.
  - Guaranteed death benefit and cash value component.
  - Can provide dividends above the guarantee.
  - Cash values serve to self-reserve and decrease the net amount at risk.

SECOND – CHOOSING BETWEEN PERMANENT LIFE INSURANCE "FLAVORS"

- Universal Life Insurance was developed as an alternative the whole life providing more flexibility as to the timing and level of premium payments.
- May include guarantees and depending on the product provide other investment options and equity exposure.
- Coverage can be permanent or for a shorter period.
- While death benefits are determined at death, premiums and cash values can be adjusted based upon the needs of the policy owner.
- Client must be disciplined to pay sufficient premiums.

CHOOSING BETWEEN STYLES OF UNIVERSAL LIFE INSURANCE POLICIES

General Account UL – permanent needs with fixed rate cash value accumulation. Clients should be disciplined in paying premiums and understand that premiums may increase if the fixed rates drop.

CHOOSING BETWEEN STYLES OF UNIVERSAL LIFE INSURANCE POLICIES

Guaranteed UL – "GUL" good for providing guaranteed death benefits, and where cash accumulation is of little importance. Not very good for changing circumstances or adjustments.

CHOOSING BETWEEN STYLES OF UNIVERSAL LIFE INSURANCE POLICIES

Equity Indexed UL – "IUL" appeals to clients who want to participate in market up-swings but limit downside risk. Often touted as a less-risk version of VUL – which it is not. Due to the insurance carrier's ability (and recent practice) to adjust crediting caps downwards, it acts more as an inflationary hedge.

CHOOSING BETWEEN STYLES OF UNIVERSAL LIFE INSURANCE POLICIES

Variable UL – "VUL" appeals to investment-oriented clients who can fund the policy adequately and who have the team or expertise to expertly control the policy's investments and cash value. Generally, not known for its guarantees modern VUL products often provide secondary guarantees for a cost.

WHERE DO WE PUT THE INSURANCE?

?

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THE INSURANCE GOES RIGHT HERE!

9 COMMON SCENARIOS WE ALL PLAN FOR, AND HOW THE INSURANCE IS PROPERLY INCORPORATED INTO THE PLAN.

1. LIQUIDITY TO SUPPORT LOVED ONES

"Human Life Value" is the economic value of a working person's lifetime earnings. At the breadwinner's death, there are those left behind who need replacement income.

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1. LIQUIDITY TO SUPPORT LOVED ONES

Susan Breadwinner

- Age 38
- Earns $125,000 annually
- Plans to stop working at 67
  - 38 years to go
- Human Life Value: $125,000 * 38 working years = **$4.75M**

- If Susan B, died tonight, her family would lose $4.75M in currently lost wages.
- **The Life Insurance Goes Right Here!** – ON SUSAN to provide liquidity for her loved ones to continue in the world to which they have become accustomed.

2. LIQUIDITY TO PAY DEBTS

There are only two reasons to buy life insurance; you love someone, or you owe someone. Life insurance is a secure way to guarantee repayment of any debt and is required or helpful to secure loans such as SBA loans, or Residential and Commercial Mortgages.

2. LIQUIDITY TO PAY DEBTS

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Joe "the hoagie king" Shopowner

- Age 51, Net worth $15,000,000
- Expands sandwich empire through leverage
- Borrows $14,000,000 to develop multiple shops around central and south Florida.
- Loan is secured by EVERYTHING

- If "the hoagie king", died tonight, his bank will call the loans and may recover their loans from the secured property.
- **The Life Insurance Goes Right Here!** – ON JOE to provide liquidity to pay his debts and allow his loved ones to continue in the world to which they have become accustomed.

3. KEY PERSON COVERAGE

Every thriving enterprise has an "all-star" key person who is integral to the present success of that business. What is the total value that the key person brings? Keep in mind the comfort suppliers, creditors, and customers might **lose** if that key person died prematurely.

3. KEY PERSON COVERAGE

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Roger Keyman

- Age 42
- 1 of 5 salespeople
- Is responsible for generating 50% of the business revenue
- Unique – hard to transfer- skills and relationships.
- Profit Margin 20% - without Roger the business would likely lose money.

- If Roger Keyman, died tonight, the business would lose his ability to drive revenue, and would likely lose key accounts.
- **The Life Insurance Goes Right Here!** – ON KEYMAN to provide liquidity to the business to assure smooth operations, replace Roger, and provide comfort to clients, creditors, and vendors.
- What about securing the business in the event Roger Keyman becomes disabled, or hurt and sick and can't work?

4. BUY/SELL

A business partnership is like a see-saw, if one person gets-off, the other person falls-off.

You can’t see-saw alone.

~Ben Feldman

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4. BUY/SELL PLANNING

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Enterprise, LLC

- 3 partners with complementary skills
- Executed LLC operating agreement states that each owner, or the entity shall buy out the departing owner at the death, disability, retirement, or insolvency of the member.
- Operating agreement takes the "wait-and-see" approach allowing either the members or the LLC to make the purchase.
  - Stock Redemption: company buys the departing shareholder's interest
  - Cross Purchase: the remaining shareholders buy the departing shareholder's interest

The Insurance Goes Right Here!

- Stock redemption: The company owns life insurance on each of the employee's and at their death uses the tax-free proceeds to buy the deceased's shares.
- Cross Purchase: each shareholder owns one policy on each of the other owners to buy out their ½ interest in a departing shareholder.

5. THE IRREVOCABLE LIFE INSURANCE TRUST

Under IRC 2042 the proceeds from a life insurance contract are includable in the policy owner's gross estate if they have <u>any incidents of ownership in the policy.</u> Incidents of ownership include but are not limited to paying premiums or having any powers under the policy.

5. THE IRREVOCABLE LIFE INSURANCE TRUST

Betty Great-Estate

- Widow (age 60)
- Has Husbands DSUE ($10M)
- Net Worth $45M
- $15M of personally owned life insurance
- Taxable Federal Estate

Don't Create A Problem, Solve One Instead!

- Personal Ownership of $15M causes a $6M tax bill.

PUT THE INSURANCE RIGHT HERE!

Betty's Irrevocable Life Insurance Trust can own the policy and not only avoid estate tax on the proceeds but enhance her overall estate by offsetting other taxes.

Not to mention Betty could have avoided any state inheritance tax!

6. SUPPLEMENTAL TAX DEFERRED SAVINGS

Outside of exotic schemes, earners who max out their qualified plan (and in some cases profit sharing plans) there are not many places to save money and defer taxes. Permanent life insurance cash values grow tax deferred and can be accessed without paying income tax via withdrawals of basis and policy loans.

6. SUPPLEMENTAL TAX DEFERRED SAVINGS

Sean Saver

- Married, Age 43, 3 Children
- W-2 Attorney earning $290,000
- Both Spouses Contribute Max 401(k)
- Savings goal shortfall $50,000 per year after tax.
- Not eligible for ROTH, or other savings options due to high income.

- **Sean Saver's Savings Options**
- Taxable Brokerage Account
- Non-Qualified Annuities
- Non-Qualified Deferred Comp plan at work
- All of these options are either tax deferred and taxed at regular income rates or are taxed along the way.

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6. SUPPLEMENTAL TAX DEFERRED SAVINGS

- **PUT THE LIFE INSURANCE RIGHT HERE!**
- Tax Deferred Growth and Income Tax Free Access.
- Maximum funded policy grows more efficiently.
- Supplement current "term" risk management with permanent life insurance.

7. BUSINESS CASH

Companies, Banks, and Insurance Companies all keep cash in the business for future investment, surety bonding, rainy day funds, future deferred compensation payments, and more…

7. BUSINESS CASH

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Issues For Business's Accumulating Surplus Cash

- Constructive Dividend Risk; statutory limits on how much cash may be accumulated inside the company.
- Reinvestment Risk
- Limited Low Risk Savings Options
- Once invested it is hard to redeploy to serve some other interest of the business

COLI/ BOLI/ ICOLI

- A business can always use more money, and just like individuals they have limited tax favored investment options.
- Businesses have many reasons to accumulate funds inside the company:
    - Shareholder Redemptions
    - Business reinvestment/ Pay down debt
    - Save for future liabilities/ Deferred compensation
    - Executive retention/ Supplemental Retirement
    - Other cash payments

7. BUSINESS CASH

PUT THE LIFE INSURANCE RIGHT HERE!

Buy permanent life insurance to help corporate clients invest business assets and protect their business and offer employee benefits.

8. REDUCE TIMING RISKS IN ESTATE PLANS

Many estate planning strategies such as installment sales, IDGT's, GRAT's, QPRT's, CLAT's, and Private Annuities, all rely on time to reach their maximum effect. A premature death could frustrate those carefully laid plans.

8. REDUCE TIMING RISKS IN ESTATE PLANNING

Common Fact Patterns:

- Fire sale of assets at death
- Sale to IDGT – not enough time to pay off the installment.
- GRAT – grantor dies too soon
- CLAT – beneficiaries hands tied until end of term
- QPRT – grantor dies too soon
- Private Annuity – grantor dies too soon

Buy Flexible Time with:

- **Term Life**
- **or UL, IUL, VUL**

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8. REDUCE TIMING RISK IN ESTATE PLANS

PUT THE LIFE INSURANCE RIGHT HERE!

- **Installment sale (Enterprise & Private):**
- Term life insurance can secure the installment payments
- **IDGT:**
- Buy permanent life insurance inside the trust using growth and income from the transferred assets. MAGNIFY the results.

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8. REDUCE TIMING RISK IN ESTATE PLANS

PUT THE LIFE INSURANCE RIGHT HERE!

GRAT: If a grantor dies before the end of the GRAT term, the amount of assets to produce the annuity will be included in the grantor's gross estate.

- Term life Insurance owned outside the estate can mitigate estate tax risk during the GRAT term.
- Permanent life insurance owned inside the GRAT using asset income or growth can MAGNIFY the results.

8. REDUCE TIMING RISK IN ESTATE PLANS

PUT THE LIFE INSURANCE RIGHT HERE!

- **CLAT (Charitable Lead Annuity Trust):**
- Fund the CLAT with a paid-up non modified endowment contract (MEC) to hedge income tax impact to the grantor.
- Use annuity stream to buy in an ILIT to permanent life insurance make a gift to the charity and keep the family transfer whole!
- **CRT (Charitable Remainder Trust):**
- Use the annuity payments to gift or loan to an ILIT to buy permanent life insurance to replace the charitable gift in a tax advantaged way.

9. HELP HNW & UHNW FAMILIES

Accredited investors are eligible to buy Private Placement Life Insurance (PPLI) which gives them access to unregistered hedge funds in an income tax efficient way.

They can also access retail investments through retail VUL.

9. HELP HNW & UHNW FAMILIES

Common Fact Pattern

- HNW/UHNW Family has assets growing in grantor trust
- Wants to limit the income tax costs
- Wants to leave money to heirs or charity
- Loves their investments

If your highly taxed investors, grantors, or trustees need insurance, PPLI could be a solution if they are accredited investors or qualified purchasers.

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9. HELP HNW & UHNW FAMILIES

- **PUT THE LIFE INSURANCE RIGHT HERE!**
  - Usually, the insurance is owned in a life insurance trust, or a trust owned LLC.
  - Transfer wealth at death by maximum funding a permanent policy with minimum insurance costs to maximize tax efficiency. (IRC 7702)
  - Investors who need to purchase permanent life insurance and want access to alternative non-registered investment options may find access through a private placement life insurance contract's investment offerings.

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9. HELP HNW & UHNW FAMILIES

Qualified Purchasers and Accredited Investors are eligible to buy Private Placement Life Insurance (PPLI) which gives them access to unregistered hedge funds in an income tax efficient way.

9. HELP HNW AND UHNW FAMILIES

Definition: Accredited Investor/ Qualified Purchaser

- An accredited investor generally is a financially sophisticated investor who has earned income that exceeds $200,000 (single)/$330,000 (couple) in each of the prior two years and reasonably expects the same for the current year, or
- Has a net worth over $1,000,000 – excluding their primary residence.
- Holds in good standing a Series 7, 65, or 82 License.
- Any trust with total assets in excess of $5M, or whose purchases are directed by a sophisticated person.
- Certain entities where all of the equity owners are accredited investors or have total investments in excess of $5M.

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SOURCE OF PREMIUMS – "BUCKETS"

- All life insurance premiums are financed. As such they are at best <u>temporary solutions.</u>

Self-Financed	Third Party Financing	Commercial Financing	Private Financing
Premiums paid by policy owner:	Money to pay premiums comes from a third party:	Commercial capital source:	Private capital source:
Income	Gifts Loans	Bank/ Institutional Loans Capital Markets Transaction	Employer loans Family Loans
Premiums are effectively back to the estate or estate equivalent (Trust) at death in the form of a death benefit	Loans must be repaid	Loans must be repaid/ securities must be repurchased/ redeemed	Loans must be repaid

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PAYING FOR THE LIFE INSURANCE

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Non-Split-Dollar "Buckets": FYI, but not discussed in detail today	Split Dollar (haiku)
• **Commercial Financing** • **"Dual Loan"** • **Private Finance/ Intra-family loans** • **Sale of assets to IDGT** • **GRAT/ CLAT**	One owns and one loans Repaid in life or at death All parties made whole. (~EE)

WHAT IS SPLIT DOLLAR LIFE INSURANCE?

POLICY BENEFITS ARE SPLIT BETWEEN TWO OR MORE PARTIES.

USUALLY, THE SPLIT BENEFITS ARE THE PREMIUM PAYMENTS, DEATH BENEFIT, AND/ OR THE POLICY CASH VALUE.

IN PRACTICE – BENEFITS MAY BE ALLOCATED IN ANY MANNER, BUT THIS IS UNCOMMON IN THE WEALTH TRANSFER ARENA.

TODAY WE DISCUSSED 9 PLACES LIFE INSURANCE IS A GOOD FIT:

- Liquidity to support family
- Liquidity to pay debts
- Mitigate loss of a key person
- Fund buy/sell plans
- Use Irrevocable Life Insurance Trust to keep assets outside of policy owner’s gross estate
- Accumulate supplemental tax deferred savings when retirement plans are not enough
- So many business uses….
- Use life insurance to smooth out timing risks
- UHNW investors who need death benefit should check out PPLI

3 WAYS YOU CAN INCORPORATE LIFE INSURANCE INTO YOUR PRACTICE (WITHOUT SELLING IT!)

Provide	Provide informed professional counsel through partnership with your top life insurance advisors.
Open and fund	Open and fund interesting planning strategies which provide counseling, drafting, and reporting opportunities for your own business.
Help	Help clients understand their need for liquidity and be a go to resource for a specific area of planning.

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Q&A?

THANK YOU!

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