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# THE END OF LIFE FOR INSURANCE IN THE ESTATE PLAN—DEATH BENEFIT, SURRENDER, LAPSE OR SETTLEMENT?

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Tama's legal tax practice focuses on both the domestic and international aspects of estate planning and family wealth transfer and tax-exempt organizations. Tama began her legal career with Vinson & Elkins in the Probate, Trusts & Estates Group of the Tax Section. After ten years at Vinson & Elkins, Tama continued her legal practice with Klosek Howes LLP and formed Klosek & Associates PLLC in June 2013. Tama has developed extensive experience in income, nonprofit (including private foundations), estate, gift, trust and generation-skipping transfer taxation and marital property planning. Tama has used life insurance extensively in her practice which focuses on advising high net worth and ultra-high net worth clients. Tama is a graduate of Harvard Law School and earned her undergraduate degree in Economics with honors from Columbia University. Tama is Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization and has been widely recognized in Houston and in the State of Texas by her peers and her clients as an outstanding attorney in her field. Tama has received a Chambers Ranking for High Net Worth—Private Wealth Law in Texas. Tama has many local and regional professional affiliations and has presented seminars on a range of topics related to her area of expertise to numerous groups in Houston, Texas and nationally. Tama joined Treyled Life Settlements LLC in March 2021 as a Managing Partner while continuing her trust and estates practice.

# Discussion Outline

## The Life Cycle of Life Insurance

- Wealthy Clients Have Life Insurance—Why?
- Types of Life Insurance Commonly Used in Estate Planning
- Wealthy People Live Longer
- When Insurance May No Longer Make Sense in the Estate Plan
- Strategies for Exiting a Life Insurance Contract
- Life Settlements
  - What is the Opportunity
  - Regulation and Tax Treatment of Life Settlements
  - Recent Private Client Case Study
  - Trust Owned Life Insurance
  - Charitable Life Settlement
  - Additional Case Studies

## Concluding Thoughts

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# Wealthy Clients Have Life Insurance—Why?

- 54% of all people in the US have some type of life insurance coverage (LIMRA 2020 Insurance Barometer Study)
  - Wealthy people are as likely to purchase insurance in all categories—HNW, UNW and mass affluent
- Income Replacement and Additional Liquidity
- Legacy
  - Providing death benefit for one or more specific beneficiaries
- Asset Protection
  - Benefits vary by state
- Liquidity
  - Estate, Gift and GST Taxes
    - Gift, estate and GST tax exemption is $11.7 million (2021) and legislation proposed to reduce this amount
      - The maximum tax rate is 40% and legislation proposed to increase rate

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# Wealthy Clients Have Life Insurance—Why?

- Income taxes
  - Gifts (under current law) receive carryover basis (IRC § 1014) and some clients have large IRD assets
- Other Liquidity Needs
  - Key man insurance/fund buyout at death of key employee

- Diversification and Tax Efficient Investment
  - The following illustration is a whole life policy designed for diversification of investment and the income-tax free appreciation and cash withdrawal beginning at age 70

# Wealthy Clients Have Life Insurance—Why?

## Internal Rate of Return Summary

**Base Policy Face Amount:** $5,000,000
**Initial Death Benefit Amount:** $5,000,000
**Premium Paying Period:** 10 years

**Premium Mode:** Annual
**Dividend Option:** Paid-Up Additions

Life insurance policies provide immediate death benefit protection and long term tax deferred cash value accumulation. The Cumulative Internal Rate of Return (IRR) is an important way to measure your Custom Whole Life policy's performance. It is equivalent to the interest rate at which the illustrated Annual Policy Cash Flow would have to be invested outside the policy (ignoring taxes) to arrive at the cash value or death benefit of the policy when non-guaranteed dividends are factored in. The Cumulative IRR is compounded annually, and assumes that all payments are paid at the beginning of each policy year.

| End of Year | Age | Annual Policy Cash Flow | Cumulative IRR on Cash Surrender Value | Cumulative IRR on Death Benefit | Cash Surrender Value | Death Benefit (BOY) |
|---|---|---|---|---|---|---|
| 1 | 46 | 188,700 | -100.00% | 2,549.71% | 0 | 5,000,000 |
| 2 | 47 | 188,700 | -61.45% | 367.18% | 100,800 | 5,000,000 |
| 3 | 48 | 188,700 | -30.14% | 158.34% | 288,258 | 5,000,533 |
| 4 | 49 | 188,700 | -17.04% | 92.52% | 483,578 | 5,001,401 |
| 5 | 50 | 188,700 | -10.29% | 61.95% | 689,269 | 5,002,754 |
| 6 | 51 | 188,700 | -6.24% | 44.80% | 909,148 | 5,011,651 |
| 7 | 52 | 188,700 | -3.61% | 34.07% | 1,143,356 | 5,038,471 |
| 8 | 53 | 188,700 | -1.79% | 26.83% | 1,392,733 | 5,081,425 |
| 9 | 54 | 188,700 | -0.48% | 21.70% | 1,658,091 | 5,140,304 |
| 10 | 55 | 188,700 | 0.61% | 17.92% | 1,951,104 | 5,214,750 |
| 11 | 56 | 0 | 1.34% | 15.78% | 2,059,599 | 5,333,800 |
| 12 | 57 | 0 | 1.87% | 14.11% | 2,171,966 | 5,450,982 |
| 13 | 58 | 0 | 2.28% | 12.79% | 2,290,687 | 5,566,431 |
| 14 | 59 | 0 | 2.61% | 11.72% | 2,416,189 | 5,686,345 |
| 15 | 60 | 0 | 2.87% | 10.85% | 2,548,642 | 5,810,939 |
| 16 | 61 | 0 | 3.09% | 10.12% | 2,688,441 | 5,940,337 |
| 17 | 62 | 0 | 3.28% | 9.51% | 2,835,824 | 6,074,886 |
| 18 | 63 | 0 | 3.43% | 8.99% | 2,991,042 | 6,214,824 |
| 19 | 64 | 0 | 3.57% | 8.53% | 3,154,312 | 6,360,264 |
| 20 | 65 | 0 | 3.69% | 8.14% | 3,326,117 | 6,511,255 |
| 21 | 66 | 0 | 3.79% | 7.80% | 3,504,284 | 6,668,104 |
| 22 | 67 | 0 | 3.87% | 7.49% | 3,691,351 | 6,826,039 |
| 23 | 68 | 0 | 3.95% | 7.22% | 3,886,904 | 6,989,342 |
| 24 | 69 | 0 | 4.01% | 6.97% | 4,091,393 | 7,156,621 |
| 25 | 70 | -293,430 | 4.07% | 6.61% | 4,002,080 | 6,808,892 |
| 26 | 71 | -293,430 | 4.13% | 6.29% | 3,908,762 | 6,470,353 |
| 27 | 72 | -293,430 | 4.17% | 6.02% | 3,811,256 | 6,141,024 |
| 28 | 73 | -293,430 | 4.21% | 5.79% | 3,709,042 | 5,820,835 |
| 29 | 74 | -293,430 | 4.25% | 5.59% | 3,601,877 | 5,508,922 |

Reflects non-guaranteed values and benefits which are based on assumptions that are subject to change by the insurer; therefore, actual results may be more or less favorable.
This is a supplemental illustration which is not valid without the attached basic illustration. Refer to the basic illustration for guaranteed values and benefits and other important information.

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# Wealthy Clients Have Life Insurance—Why?

- Types of Life Insurance Commonly Used in Estate Planning
  - Level Term—premiums paid to provide coverage for a term of years if the insured dies during the contract term; no cash value accumulates and premiums increase significantly at the end of the level term period
    - Most estate plans for younger clients use term insurance because most cost-effective coverage to insure risk of death before wealth develops and grows
    - Convertible term "locks-in" insurability at the face value of the term policy; however, conversion permanent policy options at the expiration of the term may be priced higher by the carrier
  - Permanent Insurance—combines death benefit with an investment element that is designed to appreciate and reduce the net risk in the policy and higher costs of insurance in later years

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# Wealthy Clients Have Life Insurance—Why?

- Whole life—requires highest initial premium because the carrier must guarantee pricing and cash value account growth; premiums are set using conservative assumptions for returns and mortality and maximum charges for cost of insurance and expenses and excess premiums may be returned as policy dividends
  - Cash value account designed and funded to grow to an amount equal to the death benefit at the age specified in the contract
  - Often purchased for tax-free investment and diversification
  - Can be expensive to transfer to an ILIT for estate planning depending on cash build up in contract and then not available to insured for use in retirement

# Wealthy Clients Have Life Insurance—Why?

- Universal life—unbundles the cash investment component of the policy from the death benefit; carrier is not obligated to guarantee a premium and assume the investment risk and policy assumptions are essential for long-term performance
  - UL contracts are commonly used in estate planning and may be intentionally underfunded to minimize cost while providing the option to increase premiums in later years to maintain contract
  - Cash surrender value account is the amount that will be paid to the policyowner if the contract is surrendered
  - Premiums paid may be inadequate to maintain the policy if credit ratings are less favorable than original projections or cost of insurance increases
  - Guaranteed universal life contracts ("GULs"), allow for coverage to continue regardless of the cash value account as long as premium payments timely made at guaranteed premium amount

# Wealthy Clients Have Life Insurance—Why?

  - Different investment strategies indexed universal life (“IUL”) (tied to index, such as S&P 500) and variable universal life (“VUL”) (policyowner determines how the cash account should be invested in securities)
  - VUL coverage may not be guaranteed and risk associated with death benefit making less desirable for estate planning and more advisable for clients willing to take investment risk to grow assets in contract on tax advantaged basis
- Single and joint life policies—insurance can be purchased on a single life or joint lives paying a death benefit at the second death
- Risks exist under life insurance contracts—mortality, interest rate/investment risk, insurance expense and lapse risk are shifted
  - Lapse risk offset by surrender charges or for whole life lower credit rating in early years

# Wealthy Clients Have Life Insurance—Why?

- Most large face value insurance policies are trust owned
  - In general, insurance is exempt from income tax, not estate tax (I.R.C. §§101(a)(1) and 2042)
    - Exceptions include the transfer for value rule (I.R.C. §§101(a)(2)) or if life insurance is held in a pension or retirement plan
  - Insurance held in a properly structured trust is not subject to estate tax at the death of the insured or GST tax if exemption allocated
  - Can make a gift of existing life insurance to an ILIT to transfer insurance outside of taxable estate, but clients may wish to sell insurance to grantor trust to avoid I.R.C. § 2035 and transfer-for-value rule under I.R.C. § 101(a)(2)
    - Determining value of policy is difficult and a risk in sale transaction
    - Concerns regarding grantor trusts under proposed legislation

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# Wealthy Clients Have Life Insurance—Why?

- Insurance can provide significant leverage of gift, estate and GST tax exemptions
  - Hedge against an early death prior to maturation of other transfer tax techniques
  - Insurance performs REALLY well if insured dies early—however, wealthy people live longer and many universal life policies were originally illustrated and underfunded to last only to age 85 or 90
    - Per illustration on prior slide IRRs range from 2,549% to 4.3% at life expectancy
    - IRRs may look reasonable compared with taxable investments, but whether contract performs is a function of the terms of policy

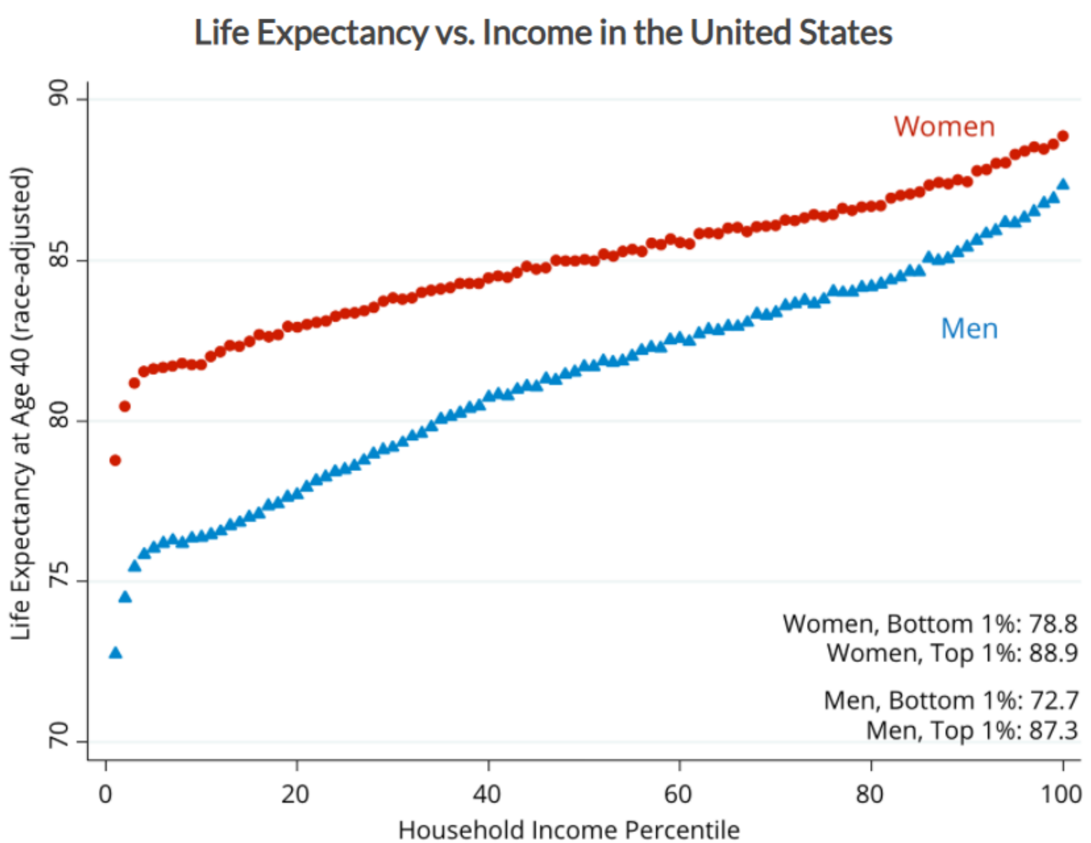
# Wealthy People Live Longer

- Average life expectancies under the Updated Static Mortality Tables for Defined Benefit Pension Plans for 2018, IRS Notice 2017-60, are 80 for men and 83 for women:

| Age | MALE 2018 Non-Annuitant Mortality Rate | MALE 2018 Annuitant Mortality Rate | MALE 2018 Optional Combined Table for Small Plans | FEMALE 2018 Non-Annuitant Mortality Rate | FEMALE 2018 Annuitant Mortality Rate | FEMALE 2018 Optional Combined Table for Small Plans |
|---|---|---|---|---|---|---|
| 80 | 0.050067 | 0.050067 | 0.050067 | 0.038490 | 0.038490 | 0.038490 |
| 81 | 0.057467 | 0.057467 | 0.057467 | 0.042601 | 0.042601 | 0.042601 |
| 82 | 0.065843 | 0.065843 | 0.065843 | 0.047227 | 0.047227 | 0.047227 |
| 83 | 0.073396 | 0.073396 | 0.073396 | 0.052439 | 0.052439 | 0.052439 |

- Wealthy persons live significantly longer than less wealthy persons—15 years longer for men and 10 years longer for women

# Wealthy People Live Longer




The richest American men live 15 years longer than the poorest men, while the richest American women live 10 years longer than the poorest women.

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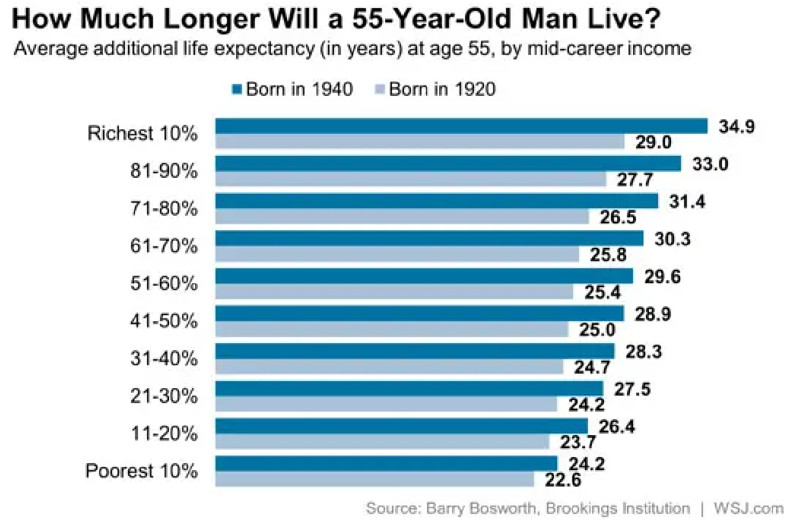
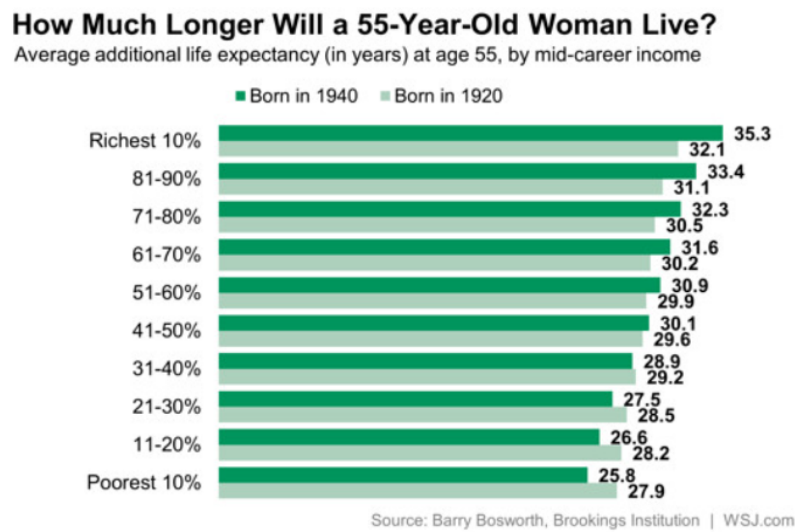
# Wealthy People Live Longer

- Wealthy men and women who have lived to 55 are expected to live to be 90
- If wealthy people live longer, life insurance as a hedge against early death unlikely to pay off—50% chance of living over age 90

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# When Insurance May No Longer Make Sense in the Estate Plan

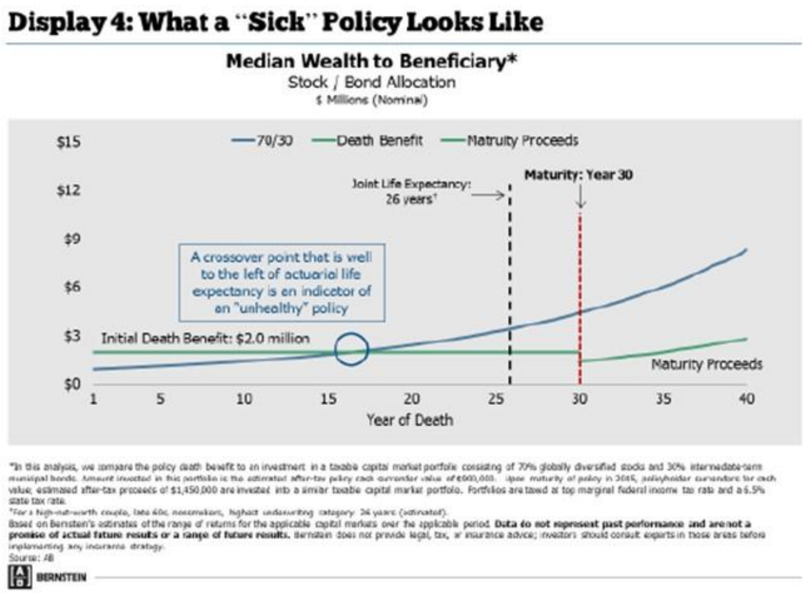
- Most term and permanent life insurance policies actually terminate or lapse before they *ever* pay a death benefit (Olin Wharton Business Schools Study 2016)
  - 88% of all universal life insurance contracts are either surrendered or lapse before ever paying a death benefit
  - Virtually all life insurance policies are front loaded, policyholders pay more than the actuarial cost of mortality risk early in exchange for paying less than their actuarial cost later
  - Insurance companies earn large profits on clients who terminate their policies, since policies are often terminated before mortality increases sufficiently above premiums paid
  - Life insurers profit from lapses and must endogenously adopt front loads to encourage lapses
  - One explanation for front-loaded premiums is sales commissions are front loaded
  - Front-loaded commissions may be used to incentivize insurance brokers to find clients without concern for whether they will hold their policies for very long—agents being paid to sell not service as contrasted with investment advisors who are paid ongoing fees for asset management

# When Insurance May No Longer Make Sense in the Estate Plan

- Life insurance is not a “buy and hold” or “set it and forget it” estate planning strategy
  - Depending on purpose of insurance, continued needs, type of contract purchased, ongoing costs of maintaining insurance versus other investment options (including other insurance) and the value within contract, decision of whether to continue, surrender, lapse or sell the contract may arise
  - From a financial perspective, there may be a crossover point where it does not make sense to maintain coverage
  - Policyowner should examine the range of returns from the universe of other investments available and actually unpack the policy illustrations to arrive at realistic returns from continued investment through updated life expectancy
  - Some policies may lapse unless significant increased premiums are paid
    - Insured may be funding his or her own death benefit and just trading funds with carrier

# When Insurance May No Longer Make Sense in the Estate Plan

- UL insurance carriers have demonstrated that they can and will increase costs of insurance which can significantly impact policy performance
- Sick vs. healthy policy analysis identifies a crossover point and requires coordination among professional advisors

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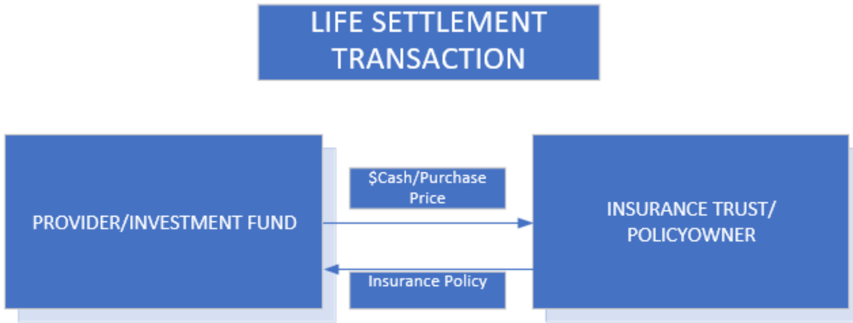
# Strategies for Exiting a Life Insurance Contract

- Most advisors, insureds and policyholders do not know that life insurance is property that can be sold (*Grigsby v. Russell*, 222 U.S. 149 (1911))
- Historically, the owner of a life insurance policy that was no longer needed, desired or advisable had two options: (1) to let the policy lapse or (2) surrender it to the insurer for its cash surrender value
- The secondary market for existing life insurance policies provides a third alternative that most advisors and clients are unaware of: (3) to sell the policy to a third party for less than the expected death benefit but more than the cash surrender value
- The value of a particular life settlement depends on various factors, including the insured's life expectancy and the nature and terms of the policy
- During 2018, 92% of all life insurance policies (by face amount) that terminated were lapsed or surrendered without paying a death benefit (American Council of Life Insurers Fact Book (2019))

# What are Life Settlements?




- At the close of a life settlement transaction, the investor owns the policy and all rights to the death benefit and pays all future premium payments
  - A life settlement provider that is regulated by the state where the policyowner resides/trust was established is the purchaser on behalf of the investor and acts as an intermediary
- The policyowner receives a lump sum payment that can be used for any purpose—including investment in other assets that may yield a higher return than continued investment in the insurance contract

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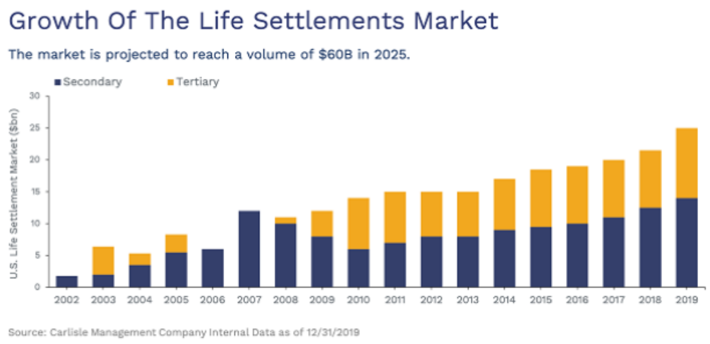
# What is the Opportunity?

- The life settlement market has evolved and is a vibrant market backed by multi-billion dollar investment funds and these funds require policies to generate returns
  - Largest purchasers—Coventry (over 40% of all transactions in 2020—spend $30M plus on DTC advertising); Coventry is a buyer but is not always an investor and sells policies purchased to investment funds in the tertiary market
  - Other investment funds are backed by Apollo, KKR, Blackstone, TPG, Vida Capital, Stone Point, McKinsey & Co.
  - Market is projected to reach a volume of $60B by 2025

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# What is the Opportunity?

- Life settlements are as seller friendly as they have ever been:
  - Tax law changes clarified that a seller's cost basis in a life insurance policy is the aggregate premiums paid without reduction for costs of insurance (I.R.C. §1016(a)(1)(B); *see also* Rev. Rul. 2020-5 (modifying Rev. Rul. 2009-13))
  - Some clients no longer require insurance with increase in estate tax exemption and success of other wealth transfer strategies
  - Increased competition in the settlement marketplace increases value to sellers
  - Regulations in 43 of the 50 United States
  - Prolonged low interest rate environment allows investors to pay more for policies
  - London Business School (2013) study concluded life settlements pay more than 4 times on average than the cash surrender value
    - For some policies, including term, a life settlement can transform a policy with little or no cash into a sizable amount

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# What is the Opportunity?

- Conning study (2018) determined that $200 billion worth of life insurance is allowed to surrender or lapse annually which results in an estimated $37.5 billion in lost wealth—lapses occur because most people do not know there is an option to sell their life insurance
- An estimated 500,000 insurance policies that may qualify for a life settlement lapse annually(Magna Life Settlements Industry Report 2018); however, in 2020 only 3,241 policies were sold in a life settlement transaction
- Universally acknowledged explanation for lapses—insureds and advisors do not know about the life settlement market

# What is the Opportunity?

- The differential between surrender value of policy and present value of the policy in a life settlement transaction creates an arbitrage opportunity
- Insurance companies could eliminate settlement market by repricing surrender values to actuarily fair amounts but fail to do so
- Some insurers have been approaching policyowners with enhanced cash surrender offers to purchase their contracts for more than the cash surrender value but the amount offered bears no relationship to the actual fair market value
  - Lincoln National recently fined by state regulators for making these offers and others are being investigated

# What is the Opportunity?

- What polices are suitable for a life settlement?
  - Individual and second-to-die universal life, indexed universal life, variable universal life and convertible term life insurance policies typically qualify for life settlements and the insured should be over 70 or under 70 with health impairment
- Only one broker should be selected to ensure maximum participation by interested purchasers and avoid polluting the file
  - Commissions on life settlements can be significant and some brokers charge a flat fee based on percentage of death benefit (for example, 8%) and others charge combined fees with agents and others receiving compensation of up to 35% of gross proceeds paid
  - Fees should be negotiated and agreed to in advance

# Regulation and Income Tax Treatment of Life Settlements

- Life settlements are authorized transactions nationwide and are regulated for consumer protection in almost every state within the United States
- To the extent the amount received in a life settlement (non-viatical) is in excess of the aggregate premiums paid less amounts received, the policy seller will have taxable gain
- The gain will be long term capital gain income unless the cash surrender value is in excess of the premiums paid less amounts received, in which case only that difference would be ordinary income (I.R.C. §1016(a)(1)(B); Rev. Rul. 2009-13 (as modified by Rev. Rul. 2020-5))
- If properly conducted, transactions can close within 60 days

# Regulation and Income Tax Treatment of Life Settlements

- The following illustrates the income tax treatment of settlement proceeds—grantor trust structure provides additional $1.2M to trust:

| Income Tax Case Study | |
|---|---|
| **Jerry Age 80** | |
| | |
| Death Benefit | $ 15,000,000 |
| Direct Purchase Initial Offer (Pre-Tax/Comission Inclusive) | $ 1,850,000 |
| Net Amount to Policyowner from Auction Before Taxes | $ 5,580,100 |
| Premiums Paid/Basis In Policy | $ 612,000 |
| Cash Surrender Value | $ 546,000 |
| Gain on Sale | $ 4,968,100 |
| Capital Gains Tax Due (23.8%) | $ 1,182,408 |
| Net Amount to Policyowner After Commission and Taxes | $ 4,397,692 |
| Direct Purchase Offer (After-Tax/Commission Inclusive) | $ 1,555,356 |
| Difference Auction and Direct Purchase (After-Tax and Commission) | $ 2,842,336 |

- Also illustrates advantage to full auction over direct purchase and surrender—$4.4M net to client vs $1.55M direct and $546,000 cash surrender value

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# Regulation and Income Tax Treatment of Life Settlements

- Sale of insurance policy on terminally ill insured ("viatical") is not taxable (I.R.C. § 101(g))
- An insured is terminally ill if physician has certified death within 24 months of the date of certification
- A viatical settlement provider defined in I.R.C. § 101(g)(2)(B) must be the purchaser for proceeds to be excluded from income

# Recent Private Client Case Study

- Client had an underfunded universal life policy held in trust that was not guaranteed to provide coverage past age 85 without significant premium increases
- Client indicated desire to discontinue making gifts, and cash value was going to be consumed in the near term to cover increased costs of insurance; there was also carrier risk with Voya which exited the insurance space
- The amount required to guarantee the insurance to age 100 was $224,000, and the client had been paying annual premiums of $75,000
- May 2021 Voya Policy Summary:

Total Face Amount: $10,000,000
Death Benefit Option: Level
Premium Class: Class 1 (Preferred Nonsmoker)
Annual Premium: $75,000.00
Total Premiums Paid: $1,705,000.00
Accumulated Value: $1,201,398.14
Cash Surrender Value: $1,201,398.14

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# Recent Private Client Case Study

- February 2020 Voya Illustration

| | | | GUARANTEED 4.50% Interest Rate Maximum Charges | | | NON-GUARANTEED ILLUSTRATED 4.50% Interest Rate Current Charges | | |
|---|---|---|---|---|---|---|---|---|
| Yr | End of Yr Age | Premium Outlay | Accumulated Value | Cash Surrender Value | Net Death Benefit | Accumulated Value | Cash Surrender Value | Net Death Benefit |
| 21 | 76 | 0.00 | 1,032,019 | 1,032,019 | 10,000,000 | 1,149,810 | 1,149,810 | 10,000,000 |
| 22 | 77 | 75,000.00 | 746,084 | 746,084 | 10,000,000 | 1,200,823 | 1,200,823 | 10,000,000 |
| 23 | 78 | 75,000.00 | 384,287 | 384,287 | 10,000,000 | 1,246,156 | 1,246,156 | 10,000,000 |
| 24 | 79 | 75,000.00 | 0 | 0 | 10,000,000 | 1,284,468 | 1,284,468 | 10,000,000 |
| 25 | 80 | 75,000.00 | 0 | 0 | 10,000,000 | 1,314,345 | 1,314,345 | 10,000,000 |
| | | 300,000.00 | | | | | | |
| 26 | 81 | 75,000.00 | 0 | 0 | 10,000,000 | 1,334,287 | 1,334,287 | 10,000,000 |
| 27 | 82 | 75,000.00 | 0 | 0 | 10,000,000 | 1,342,687 | 1,342,687 | 10,000,000 |
| 28 | 83 | 75,000.00 | 0 | 0 | 10,000,000 | 1,337,810 | 1,337,810 | 10,000,000 |
| 29 | 84 | 75,000.00 | 0 | 0 | 10,000,000 | 1,318,908 | 1,318,908 | 10,000,000 |
| 30 | 85 | 75,000.00 | 0 | 0 | 10,000,000 | 1,282,824 | 1,282,824 | 10,000,000 |
| | | 675,000.00 | | | | | | |
| * 31 | 86 | 75,000.00 | 0 | 0 | 0 | 1,227,259 | 1,227,259 | 10,000,000 |
| 32 | 87 | 75,000.00 | 0 | 0 | 0 | 1,149,639 | 1,149,639 | 10,000,000 |
| 33 | 88 | 75,000.00 | 0 | 0 | 0 | 1,047,068 | 1,047,068 | 10,000,000 |
| 34 | 89 | 75,000.00 | 0 | 0 | 0 | 916,253 | 916,253 | 10,000,000 |
| 35 | 90 | 75,000.00 | 0 | 0 | 0 | 753,435 | 753,435 | 10,000,000 |
| | | 1,050,000.00 | | | | | | |
| 36 | 91 | 75,000.00 | 0 | 0 | 0 | 643,518 | 643,518 | 10,000,000 |
| 37 | 92 | 75,000.00 | 0 | 0 | 0 | 507,897 | 507,897 | 10,000,000 |
| 38 | 93 | 75,000.00 | 0 | 0 | 0 | 344,354 | 344,354 | 10,000,000 |
| 39 | 94 | 75,000.00 | 0 | 0 | 0 | 147,759 | 147,759 | 10,000,000 |
| * 40 | 95 | 75,000.00 | 0 | 0 | 0 | 0 | 0 | 0 |
| | | 1,425,000.00 | | | | | | |

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# Recent Private Client Case Study

- May 2021 Voya Illustration

| | | | | GUARANTEED<br>*4.50% Interest Rate*<br>*Maximum Charges* | | |
|---|---|---|---|---|---|---|
| | Yr | End of Yr Age | Premium Outlay | Accumulated Value | Cash Surrender Value | Net Death Benefit |
| | 22 | 77 | 0.00 | 1,148,389 | 1,148,389 | 10,000,000 |
| | 23 | 78 | 75,000.00 | 823,299 | 823,299 | 10,000,000 |
| | 24 | 79 | 75,000.00 | 412,662 | 412,662 | 10,000,000 |
| | 25 | 80 | 75,000.00 | 0 | 0 | 10,000,000 |
| | | | 225,000.00 | | | |
| | 26 | 81 | 75,000.00 | 0 | 0 | 10,000,000 |
| | 27 | 82 | 75,000.00 | 0 | 0 | 10,000,000 |
| | 28 | 83 | 75,000.00 | 0 | 0 | 10,000,000 |
| | 29 | 84 | 75,000.00 | 0 | 0 | 10,000,000 |
| | 30 | 85 | 75,000.00 | 0 | 0 | 10,000,000 |
| | | | 600,000.00 | | | |
| * | 31 | 86 | 75,000.00 | 0 | 0 | 0 |
| | | | 675,000.00 | | | |

* Year 31, Month 1 (August 2029)
In the event that the guaranteed costs were deducted and the guaranteed interest rate was paid from 5/19/2021 forward, the policy would lapse and cannot be quoted beyond the year shown. Additional premiums would be required to continue the coverage.

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# Recent Private Client Case Study

- May 2021 Voya Illustration

| | | | | GUARANTEED<br>*4.50% Interest Rate*<br>*Maximum Charges* | |
|---|---|---|---|---|---|
| Yr | End of Yr Age | Premium Outlay | Accumulated Value | Cash Surrender Value | Net Death Benefit |
| 22 | 77 | 0.00 | 1,148,389 | 1,148,389 | 10,000,000 |
| 23 | 78 | 223,889.00 | 969,526 | 969,526 | 10,000,000 |
| 24 | 79 | 223,889.00 | 720,217 | 720,217 | 10,000,000 |
| 25 | 80 | 223,889.00 | 385,929 | 385,929 | 10,000,000 |
| | | 671,667.00 | | | |
| 26 | 81 | 223,889.00 | 0 | 0 | 10,000,000 |
| 27 | 82 | 223,889.00 | 0 | 0 | 10,000,000 |
| 28 | 83 | 223,889.00 | 0 | 0 | 10,000,000 |
| 29 | 84 | 223,889.00 | 0 | 0 | 10,000,000 |
| 30 | 85 | 223,889.00 | 0 | 0 | 10,000,000 |
| | | 1,791,112.00 | | | |
| 31 | 86 | 223,889.00 | 0 | 0 | 10,000,000 |
| 32 | 87 | 223,889.00 | 0 | 0 | 10,000,000 |
| 33 | 88 | 223,889.00 | 0 | 0 | 10,000,000 |
| 34 | 89 | 223,889.00 | 0 | 0 | 10,000,000 |
| 35 | 90 | 223,889.00 | 0 | 0 | 10,000,000 |
| | | 2,910,557.00 | | | |
| 36 | 91 | 223,889.00 | 0 | 0 | 10,000,000 |
| 37 | 92 | 223,889.00 | 0 | 0 | 10,000,000 |
| 38 | 93 | 223,889.00 | 0 | 0 | 10,000,000 |
| 39 | 94 | 223,889.00 | 0 | 0 | 10,000,000 |
| 40 | 95 | 223,889.00 | 0 | 0 | 10,000,000 |
| | | 4,030,002.00 | | | |
| 41 | 96 | 223,889.00 | 0 | 0 | 10,000,000 |
| 42 | 97 | 223,889.00 | 0 | 0 | 10,000,000 |
| 43 | 98 | 223,889.00 | 0 | 0 | 10,000,000 |
| 44 | 99 | 223,889.00 | 0 | 0 | 10,000,000 |
| 45 | 100 | 223,889.00 | 0 | 0 | 10,000,000 |
| | | 5,149,447.00 | | | |

# Recent Private Client Case Study

- In 2021 Voya would no longer illustrate the non-guaranteed contract that was illustrated in 2020
- Average life expectancy from multiple reports indicated a 14.8 year life expectancy (50% chance that client would live longer than 14.8 years)—well beyond the potential for lapse
  - 76% chance that client will live beyond age 85
- Pre-pricing analysis indicated the policy value would be in excess of the total premiums paid ($1.7M) and may be significantly higher
  - Trustee confirmed willingness to approve a sale for an amount net of fees equal or greater than total premiums paid
  - Net amount received by trust was almost $1M greater than total premiums paid and $1.5M greater than cash surrender value

# Recent Private Client Case Study

- Actual Life Settlements Auction Results

| | Provider 1 | Provider 2 | Provider 5 | Provider 3 | Provider 4 | | Bid IRR | Bid Increase |
|---|---|---|---|---|---|---|---|---|
| Bid 1 | $1,512,000 | | | | | | 15.24% | |
| Bid 2 | | $2,200,000 | | | | | 11.17% | $ 688,000 |
| Bid 3 | | | | $2,300,000 | | | 10.73% | $ 100,000 |
| Bid 4 | $2,400,000 | | | | | | 10.31% | $ 100,000 |
| Bid 5 | | | | | $2,600,000 | | 9.53% | $ 200,000 |
| Bid 6 | | | $2,625,000 | | | | 9.44% | $ 25,000 |
| Bid 7 | | $2,700,000 | | | | | 9.18% | $ 75,000 |
| Bid 8 | $2,725,000 | | | | | | 9.09% | $ 25,000 |
| Bid 9 | | | $2,750,000 | | | | 9.00% | $ 25,000 |
| Bid 10 | $2,775,000 | | | | | | 8.92% | $ 25,000 |
| Bid 11 | | $2,850,000 | | | | | 8.67% | $ 75,000 |
| Bid 12 | | | $2,875,000 | | | | 8.59% | $ 25,000 |
| Bid 13 | $2,885,000 | | | | | | 8.56% | $ 10,000 |
| Bid 14 | | $2,913,000 | | | | | 8.47% | $ 28,000 |
| Bid 15 | $3,015,000 | | | | | | 8.15% | $ 102,000 |

- Provider 1 was opening bid at $1.5M and the highest bid at $3M—without auction $1.5M offer would have been more than cash surrender and may have been accepted

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# Trust Owned Life Insurance

- Trustees have fiduciary duties to monitor and manage policies held in trust
- Trustees may not be aware that if a donor does not wish to continue to make premium payments there is an option for a settlement to preserve value
  - 90% of all insurance trust fiduciaries have no specialized knowledge or skills to manage insurance
  - Trustees should obtain regular policy statements and in force illustrations and coordinate reviews and/or audits with an insurance professional
  - Trustees should confirm and communicate to donor/grantor and beneficiaries when policies held in trust are projected to lapse

# Trust Owned Life Insurance

- Life settlement is an important option for all trustees, including corporate trustees, to understand and preserve value to trust beneficiaries
  - Proceeds are greater than from surrender (or lapse) and continue to be held for the benefit of desired beneficiaries under trust terms
  - Grantor pays income taxes for policies held in grantor trusts
- Exculpatory clauses may not protect trustee from liability for breach of fiduciary duties (*Rafert v. Meyer*, 209 Neb. 219 (2015))

# Charitable Life Settlement

- Clients with life insurance that is no longer required or desired may wish to benefit charity/DAF currently
  - Charitable gift of life insurance can be combined with a settlement to extract value for current giving
  - May be an option for trust owned insurance as well
- Deduction should equal the fair market value of the policy reduced by any portion that would be ordinary income if the policy were sold (Rev. Rul. 2009-13; Treas. Regs. § 1.170A-4(b)(1))
- Donation must be reported on IRS Form 8283, Noncash Charitable Contributions, and a qualified appraisal obtained (I.R.C. §170(f)(ii)(c))

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# Charitable Life Settlement

- Gross amount paid in a life settlement transaction should establish fair market value of policy for qualified appraisal
  - Fair market value should be gross purchase price without reduction for costs associated with sale similar to valuation of assets for estate and gift tax purposes that do not reflect costs of sale even though amount received is net (Treas. Reg. § 20.2031-1(b) and § 25.2512-1; *see also Estate of Smith v. Comm'r* (1972))
- Charities already owning insurance can also consider a settlement to accelerate receipt of funds for charitable purposes and avoid additional premium contributions that may not be provided by the insured/donor or advisable

# Additional Case Studies

***Example 1:*** **SIMON, age 75**

**Type of policy:** Indexed Universal Life

**Policy Face Value:** $10,000,000

**Cash Surrender Value:** $1,378,000

**Summary:** A policyowner had premium financed an aggressively illustrated Indexed Universal Life policy, and the policy had not performed as projected. In connection with the premium financing, the policyowner had provided a secured note to the lender for $2,411,000 that scheduled to mature within 30 days, meaning the client was going to have to pay about $1,000,000 out of pocket to the lender or risk losing a valuable income producing family-owned property that was posted as the collateral. At that time, the policyowner could not afford the additional $1,000,000 in cash required to repay the amount due under the note. The policyowner engaged Treyled Life Settlements to sell the contract and to help minimize the client's out of pocket expense on unwinding the contract. After the Treyled began the auction process, the policyowner not only was able to repay the outstanding note in its entirety but also made a significant profit on the sale. The opening offer received was $2,200,000.

**Final Gross Offer Received and Paid:** $4,051,000

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# Additional Case Studies

*Example 2*: SARAH, age 79

**Type of policy**: Guaranteed Universal Life

**Policy Face Value**: $855,000

**Cash Surrender Value**: $131,000

**Summary:** A policyowner was in great health and did not want or need the life insurance coverage any longer, and she was simply planning on surrendering the contract for the $131,000 cash surrender value. The policyowner's advisor informed her that she may be able to sell the policy for more than the cash surrender value. Treyled Life Settlements received an opening offer of $228,000.

**Final Gross Offer Received and Paid:** $375,000

*Example 3*: RON, age 66

**Type of policy**: Convertible Term

**Policy Face Value**: $1,500,000

**Cash Surrender Value**: $0

**Summary**: The client's term policy was about to expire, and the policy needed to be converted to permanent or it would lapse with no value. The conversion premium was $98,000 per year, and the client did not wish to pay the increased cost. The case was "shopped" by another broker, and the maximum offer negotiated was $200,000. The client was referred to Treyled Life Settlements for another opinion. After completion of the TLS auction process, the client received more than double the maximum offer negotiated by the prior broker.

**Final Offer Received and Paid**: $495,000

# Concluding Thoughts

- Studies have found that *an estimated 88% of all universal life insurance policies issued are surrendered or lapse before paying a death benefit*
  - A staggering amount of premium dollars are wasted
- Estate planning attorneys, wealth advisors, corporate fiduciaries, accountants and insurance advisors can assist clients to recover funds trapped in life insurance that is no longer desired or advisable and avoid continued investment in contracts that do not provide an optimal result
  - Ask clients about their life insurance at the client intake or at your next meeting (See Exhibit C for Sample Life Insurance Discussion Summary)
  - Insurance should continue to be monitored and managed similar to other investment strategies—regular policy reviews are essential

# Concluding Thoughts

- Become informed regarding life settlements and share this information with clients and others at your firm in advance of policy lapses or surrenders
  - Consider adding information about life settlements to firm insurance trust memoranda and other materials
  - For attorneys and corporate trustees, consider adding life settlements to insurance trust powers specifically authorizing the sale of insurance held in trust
- Exculpatory clauses may not protect from liability for breaches of fiduciary duties such as care and duty to inform
- Not every policy is a candidate for a life settlement

# Concluding Thoughts

- A life settlement auction process conducted by a single knowledgeable team creates real competition in the market and yields better pricing than a direct sale to a purchaser and more than the cash surrender value
- Discussions with clients and others at your firm regarding life insurance can lead to numerous opportunities with the client and within your firm, and if there is a different insurance need, alternative wealth transfer or investment strategy or life settlement opportunity, the advisor may bring a valued solution to a problem which builds on the existing trust in the advisor and the firm