The
Efficient Edge
Protecting tomorrow begins today.

Client and Multi-Family Office
Contract Assessment Summary

Setting the Stage:

- Client has a $1,000,000 whole life policy from a solid mid-size insurance company
- Their goal is to find out if what they have is a good and valuable piece of property
- They have also expressed an interest in finding out if there are market opportunities that would serve their goals more efficiently
- He is healthy and she has had some health issues
- Client has a desire to provide a death benefit to his wife because they have no children and no plans to expand their family

Efficient Edge Opportunity Matrix™

- Analyze their current life insurance policy and actuarially determine its worth
- Explore if there are opportunities with their current coverage or open market options that would be more efficient in serving their needs

Efficient Edge Analysis

You have a Whole Life policy. This is the "granddaddy" of long-term permanent life insurance. Whole life is the original form of life insurance. Whole Life is built on guarantees and therefore, the least flexible of any of the types of life insurance. It integrates all the mathematical elements of life insurance: premium, cash value, investment returns, expenses and mortality. There is no transparency as with many of the other types of life insurance. In its simplest form, you pay the stated premium on time and the insurance company guarantees that no matter when the insured dies the death benefit will be paid, subject only to the financial viability of the insurer.

The three basic components of whole life are: mortality, expenses and cash value. They are guaranteed never to change. The cash value exists to support the level premium and decreasing net amount at risk structure. The mortality and expenses are calculated based on many factors (home office, health, type of policy, lapse estimates, etc...) and are "packed" into the premium and guaranteed. The cash value is invested in the general account assets of the insurance company which have to follow conservative risk-based capital ratio investment guidelines. Based on current year expenses, claims paid, surplus requirements, required reserve allocations, and returns generated by the insurance company the policy is paid a dividend. The dividend is a tax free return of premium and the only component not guaranteed in a Whole Life policy. If any of the components are not behaving as expected then the dividend is affected. The dividend can be used to; reduce premiums, accumulate in an interest bearing account, paid in cash, or reinvested back into the policy through paid-up life insurance.

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Cash value in Whole Life insurance is created by the payment of a level premium that, in the early years, is significantly higher than the underlying cost of the yearly risk of death. The excess premiums accumulate each year and essentially earn the insurance carrier's contractually guaranteed rate of return, building a reserve for risk charges that will be substantially higher than the level premium in the insured's later years. The death benefit of a Whole Life policy consists of the cash value + the net amount at risk (the difference between the cash value and the death benefit). Whole Life policies consist of guaranteed amounts of gradually increasing cash value and correspondingly decreasing net amount at risk. And this would seem to be the most natural way to balance today's low probability of death with the certainty of death in the future: As the chance of death increases from year to year, the pure insurance element decreases to manage the overall cost of the policy and allows the insurance company to guarantee the level premium.

Your policy would be affected by any loans. Loans decrease dividend payments and are subtracted from the death proceeds if still outstanding at death. Interest on loans is paid in arrears. The interest rate is stated in the contract and is usually 6%.

You are currently paying the premiums by using the dividend + harvesting some of the cash value of the paid up life insurance that was bought with past dividends. Once the dividend is larger than the premium the illustration assumes the reinvestment of the excess dividend. This approach to paying for your life insurance is common. It is dependent on the dividend. If the dividend payments are lower than projected and you harvest all of your paid-up life insurance cash value then you will need to pay some premium until the dividend is substantial enough to pay the entire premium. Once you have used up all your available paid-up life insurance cash value the premium will reappear for a period of time. If you do not pay the premium then your policy will borrow money from the guaranteed cash value of the policy. You jeopardize the integrity of the policy if you borrow too much against your policy.

Your current net dividend yield is 3.68% and they have projected a lower yield over time which is normal. You have paid in over the last 14 years $165,971 or 1.66% of the face amount and based on the current dividend scale you will not have to pay any future premiums.

The IRR on projected death benefit:

- Age 57 / 10 yrs. 20%
- Age 67 / 20 yrs. 9.92%
- Age 77 / 30 yrs. 6.87%
- Age 85 / Life Expectancy 5.72%
- Age 87 / 40 yrs. 5.47%
- Age 97 / 50 yrs. 4%

I requested a "full pay" illustration which they did not supply in order to review the value of continuing to pay the premium and to study the IRR and leverage of this option. They could not provide us with an illustration that would show the dividend scale at 100 bps below the current scale. Based on our research the company integrity is high. They are a mid-size conservative life insurance company which is part of a well-diversified financial services company.

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In summary, the Client should feel comfortable with his current life insurance policy. His IRR is quite attractive. Since they do not desire to deposit more money into their current life insurance policy the only risk I see is if the dividend that is currently projected decreases then he would have to pay premium amounts. The premium amounts that would be paid would not be more than the stated premium in his contract ($12,070).

Tabular Life Expectancy

- Client
  - Normal: 85.2
  - 85%: 95.5
- Mrs. Client
  - We would recommend our Actuarial Longevity Analysis (ALA) Report (personalized life expectancy)

In taking our analysis to the next step we have examined the following based on the fact they desire no future premium payments:

- If the insured can qualify for a preferred or better health class rating then he can, with a one-time tax-free rollover contribution of the cash value under IRS section code 1035 ($195,000) from his present policy, increase his leverage by 60% to 80% ($1.6mm to $1.8mm) but the policy death benefit would remain level for his lifetime in a no-lapse guaranteed death benefit type policy
- We have compared this scenario to his current policy assuming the current dividend scale stays the same and found that the growth in death benefit based on the dividend payments would not reach that level until mid to late 90's
- We also wanted to provide a comparison to a joint life policy with a one-time dump in of $180,000 which provides even more death benefit leverage even after considering his wife's health conditions. Our analysis showed that they could obtain about $2 mm to $2.3 mm of death benefit.
  - Since you cannot tax-free exchange a single life policy for a joint life policy we needed to find out the gain in the policy upon surrender to calculate the after-tax contribution amount

Based on our discussion and they decided not to pursue the joint life opportunity, therefore, we found it not necessary to obtain an ALA report.

We discussed the purpose of the life insurance within the context of the Client's overall estate plan. In general, the discussion for high net worth families' shifts from a desire to provide the traditional liquidity life insurance provides to a family for spousal income needs and estate debt reduction to a consideration of the following:

- Estate leakage caused by estate taxes, estate administration costs, lack of time within the planning process. Estate plans mature over time and consist of many tools that at a young age can be difficult to implement due to their irrevocable nature.

- Tax and estate leverage which life insurance by its very nature employs. Life insurance set up properly in an estate can be exempt from both income taxes and estate taxes enhancing the IRR significantly.
- Legacy needs and freedom in the long term planning process. Not knowing how life for you and your extended family may unfold may require life insurance to allow for events not in your control.
- Charitable planning may become more important as years go by and life insurance can play an important part in wealth replacement designs or estate leverage discussions.
- Liquidity needs to cushion the estate from volatile markets and business decisions.

We would consider gifting the insurance to an ILIT in order to remove the proceeds from your estate and to control the distribution of proceeds. ILIT's require certain procedures are followed to qualify as a present interest gift. We recommend you discuss this technique and its tax implications with Oxford Financial.

Action

We were engaged to pursue underwriting to see if his rate class would fall into the preferred or better category. The Client was found to be "super preferred" which meant he could, with a one-time 1035 tax-free rollover of $195,000, increase his leverage by 80%. Our analysis had concluded that this 80% increase in death benefit would not be obtained until age 98 under his current plan and provide more significantly more death benefit with a higher internal rate of return. The IRR at age 97 was 4.55% and at age 85 the IRR was 6.02%.

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