



Case Study

The Wolf Family

REBALANCING INSURANCE ASSETS TO MITIGATE RISK AND SUPPORT TRUST OBJECTIVES

BACKGROUND:

An advisor came to us for advice regarding one of her clients. As part of his estate plan, the client had established trusts for each of his two daughters. The advisor wanted to ascertain if the insurance policies in the trusts were being adequately funded and if they represented the best use of the trust's capital. She has crafted an estate plan that meets all of her client's objectives, but also understands the execution of that plan will rely on the stability of the underlying assets.

- The client's children are trustees of the trusts. Both the advisor and the trustees understand they do not have the necessary technical expertise to analyze the life insurance policies (the only assets within the trusts).
- The original (as sold) projections required premiums to be paid for a limited number of years. They have now paid annual premiums for a greater period of time than originally expected.
- Gift taxes are being paid annually - the trustees want to discover if this is still necessary, or if the gift tax burden may be mitigated in any way.



THE SITUATION:

Here is an example in which active intervention revealed funding shortfalls and provided leverage to support and reallocate the capital in the trusts.

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Mr. Wolf is a 78 year-old widower with a current net worth in excess of \$50 million. His estate is extremely liquid following the sale of his closely held business to a public company. The insurance in his trusts were originally acquired to provide liquidity. Despite the fact he no longer needs the coverage for its original purpose, he still feels the capital in the trusts should be retained and managed for the benefit of his children. As trustees, the children are less concerned about these assets, but want to fulfill their father's wishes.

Each trust has a total of \$15 million of life insurance, composed of two universal life policies and two whole life policies. The universal life policies provide the majority of the death benefit, totaling \$10 million with the \$5 million balance provided by the whole life policies. Each of the policies is being funded with identical premiums of \$50,000 per year (a total of \$200,000 for each trust).

THE SOLUTION:

After analyzing the existing contracts, it was determined the universal life policies would remain in force for five and eight years respectively, based on the current funding level and rate of return. Without additional funding, the trusts would each retain a total of five million in death benefit after paying premiums with the expectation that the heirs would receive fifteen million from each trust. In addition, the whole life policies had very high cash values which reduced the value of the insurance component of the policies (the net amount at risk, or NAR, to the insurance company). This created an unrecognized cost to the trusts from the foregone investment return of the underlying cash value.

The projected premiums required to keep the universal life policies in force (to Mr. Wolf's age 100) were double the current premiums, or \$200,000 per year, bringing the total required trust outlay to \$300,000 per year for each trust. Discussions with two insurance companies did not provide competitive alternatives for internal exchange of either policy, and both companies would require full medical underwriting were any changes requested.

A preliminary estimate of the universal life policies' value to the settlement market indicated the trusts could probably double the cash value (of \$750,000 per trust) if the policies were offered. The actual outcome of the settlement negotiations provided each trust with 2.5 times the original cash value, or \$1,875,000. To replace the insurance in the trust, we approached seven life insurance companies on a preliminary basis. We received a preferred offer from one company despite Mr. Wolf's medical history, which included recovery from cancer and chemotherapy. To provide additional leverage for the trusts, two-thirds of the settlement proceeds were placed in an immediate annuity with the balance paid out to each trusts' beneficiaries.

Following the restructuring of the portfolio, the trusts had the same out of pocket funding requirements as originally projected for the \$15,000,000 of coverage. The \$10,000,000 of new universal life coverage was now fully guaranteed for Mr. Wolf's lifetime. In addition to keeping premium funding requirements level, the beneficiaries immediately received \$625,000 from each trust. Mr. Wolf also had the pleasure of participating in the process, allowing his beneficiaries to receive a portion of their inheritance while he could enjoy it with them.

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