

Spectra Building 1
Suite 301
2593 Wexford-Bayne Road
Sewickley, PA 15143

Phone: 724-935-5454
Fax: 724-935-5456
www.clearpointadvisorsllc.com

News in Brief: Market Update

Tax Management Solution

Special points of interest:

- Institutional pricing provides unique value proposition
- A multitude of asset allocations can be accommodated

Private placement life insurance (PPLI) is a relatively new product in the life insurance field. It has only been readily available for the past 15 years or so, and even today there are only a handful of insurers that offer the product. Rarer still are the insurance agents and financial advisors that have made the jump from traditional life insurance to these new products. PPLI products tend to be dramatically different from traditional products—even traditional variable universal life insurance.

It's viewed as an insider's secret for the affluent: a legal way to invest in hedge funds and other potentially lucrative assets, all without paying taxes on the gains.

But private placement life insurance, as it is known, is still unfamiliar to many wealthy people—and trickier to design properly than even some savvy investors realize, tax lawyers and financial advisors say.

The Internal Revenue Code treats the taxation of insurance differently from that of investments, like stocks or hedge funds, and does not levy fed-

eral income tax or the 15% capital gains on a life insurance policy when it pays out upon the death of the holder. So by stuffing an otherwise taxable investment inside a tax-free life insurance policy, investors can reap the compounded gains of that investment and the death benefit, all tax-free.

Generally, the core motivation for acquiring a PPLI product is to establish a tax-free investment environment, at the lowest possible cost, in which a client may designate hedge fund or traditional money manager(s) to manage assets paid into the PPLI policy. However, the death benefit component of PPLI should not be overlooked, as it provides tremendous wealth transfer and estate tax mitigation strategies, and may also be used to fund the client's philanthropic desires, such as a favorite charity or the creation of a family foundation.

There are other lucrative benefits besides the absence of income taxes. When structured properly, the gains and the death benefit can escape estate taxes and go to your heirs tax-free when you die. Investors

may also be able to borrow up to 90% of the gains from the policy without paying taxes on the loan.

Investment flexibility - investment direction

The policyholder has a very flexible choice of investments, virtually any bankable asset (and an astonishing range of non-bankable assets) can be structured. Essentially:

- The policyholder selects a broad investment strategy
- Asset manager has a discretionary mandate to manage the assets
- The asset manager is usually designated by policyholder but actually hired by the insurer
- A "Chinese Wall" to prevent direct communication between policyholder and investment manager is typically contractually agreed

Tremendous flexibility in investment choice

Insurance laws generally stipulate that contracts in which the

Tax Management Solution (cont.)

- **Institutional product minimizes insurance amounts and falls within IRS definition of life insurance.**
- **Contract holder maintains benefit of account growth and distributions falling under insurance, taxation rules.**

policyholder bears the investment risk, the insurance company can in principle make use of any investment for which the policyholder is willing to accept the risk. The policyholder thus participates directly in the development of the investment. The insurance carrier sets up a depot account with the custodian bank for each individual policy, allowing individual assets to be assigned directly to individual policies. The policyholder can determine the investment strategy, designate the asset manager to implement the strategy. The asset manager implements the desired investment strategy in the account. The policyholder's wishes may range from:

- A conservative fixed income portfolio
- 100% listed equity
- A private equity portfolio
- Hedge funds

In general, the policyholder is prohibited from making investment decisions himself. He may only define strategy and

designate the asset manager. This is known as the owner-control rule.

As an asset protection vehicle, PPLI offers financial privacy and, in some cases, significant protection from future creditors.

While the PPLI product is similar to a traditional variable universal life insurance policy in its mechanics, PPLI has some exceptional differences that separate it in the context of the high net worth client:

- The policy owner has broader flexibility with regard to the policy's underlying investments, and many hedge funds and other tax-inefficient investment choices are available.
- They must be an "accredited investor" and "qualified purchaser" as defined by the SEC, which means they must earn at least \$200,000 a year and have investable assets of at least \$5MM. The insured must qualify medically for an insurance policy.

- Insurance fees are more competitive than retail insurance products. In most cases, there are low front-end loads on premium payments, the annual charges against policy cash values are a small fraction of the annual tax cost associated with similar investments in a taxable environment, and PPLI policies typically have no surrender charges. As a general rule, total policy fees should be less than 1%-1.25% as expressed a percentage of the cash value. Stated another way, a 10% investment return of the underlying investment values will yield a return on the cash value of the policy of approximately 9%-significantly higher than an otherwise after-tax return 6.5% (assuming a 35% tax rate applied on a 10% return).

Summary

The advisor must consider investments, income taxation, estate taxation, asset security and philanthropy in unison to achieve optimal results.

Contact Us:

Clearpoint Advisors, LLC
Spectra Building 1, Suite 301
2593 Wexford-Bayne Road
Sewickley, PA 15143
724-935-5454
www.clearpointadvisorsllc.com