

## Q&A ~ Private Placement Life Insurance

### ◆ What is Private Placement Life Insurance?

Private Placement Life Insurance ("PPLI") is a variable universal life insurance product designed for high net worth investors. It is offered by both domestic and foreign insurance companies and provides policy holders with sophisticated asset management choices, including a wide variety of hedge funds and hedge funds of funds.

### ◆ Why are investors interested in PPLI?

Generally, the core motivation for acquiring a PPLI product is to establish a tax-free investment environment, at the lowest possible cost, in which an investor may designate hedge fund or traditional money manager(s) to manage the assets paid into the insurance policy. The death benefit component of the policy usually is considered a secondary benefit.

### ◆ What are the income tax advantages of life insurance?

The income tax benefits of life insurance include: (1) tax-free earnings (dividends, interest, and capital gain) on policy assets; (2) the ability to withdraw and to borrow assets from the policy cash value free of income tax (with proper structuring); and (3) the receipt of policy proceeds by the policy beneficiaries at the death of the insured on an income tax-free basis.

### ◆ What are the main differences between PPLI and retail life insurance?

- ◆ The policy owner has broader flexibility with regard to the policy's underlying investments, and many hedge fund investment choices are available. However, the policy owner cannot exercise direct or indirect control over the investment of the policy assets.
- ◆ Policy purchasers must meet "qualified purchaser" and "accredited investor" guidelines under SEC rules.
- ◆ Fees are typically more competitive than retail insurance products. In most cases, there are low front-end loads on premium payments, and the annual charges against policy cash values are a small fraction of the annual tax cost associated with similar investments in a taxable environment.

### ◆ What factors influence whether a PPLI policy should be acquired from an offshore versus a domestic life insurance company?

- ◆ Premium payments to non-U.S. life insurance companies generally are not subject to U.S. state premium taxes, which can range from 1-3% of premium. In addition, the U.S. "DAC" tax (approximately another 1% to 1.5% with domestic carriers) is sometimes lower offshore. Although many offshore carriers elect to be taxed as a U.S. corporation, a U.S. federal excise tax of 1% is imposed on policy premiums on U.S. lives that are paid to foreign life insurance companies that are not taxed as U.S. corporations.
- ◆ Investment flexibility may be greater offshore due to the absence of SEC and state insurance and security law regulation; also, in many cases, the insurance-related fees are lower than the domestic policy equivalent.
- ◆ With proper planning, a higher level of asset protection is available with offshore PPLI policy purchases.



◆ **How should investors acquire a PPLI product?**

Although most investors are drawn to PPLI for its tax benefits, investment flexibility, and price structure, few regard the life insurance benefit as an important feature. However, the life insurance component of the product is critical and there are many technical insurance issues to address in the process of acquiring a PPLI product. Accordingly, it is advisable to engage legal counsel with insurance and estate planning expertise, and it generally is also advisable to involve a highly knowledgeable insurance professional with specific and broad PPLI experience in the product acquisition process.

◆ **How much should an investor commit to PPLI?**

Generally, for optimal price efficiency, the total minimum premium commitment should be \$5,000,000. If the investor wants to have the flexibility to withdraw or borrow policy assets on a tax-advantaged basis, the total premium commitment should be paid in equal installments over a period of time, typically four to five years.

◆ **What are the fees typically associated with PPLI?**

There are three primary insurance-related fees associated with PPLI products: the premium load, the "mortality and expense" charge, and the cost of insurance charge. The premium load will vary, but should typically be approximately 1% of premium, and the combination of the mortality and expense charge and the cost of insurance charge should average, over the life of the contract, less than 1% per year. Asset management fees will depend on the asset manager(s) selected to manage the insurance portfolio.

◆ **What is involved in the acquisition process?**

Acquiring PPLI requires that the prospective insured undergo full medical and financial underwriting, and in the case of an offshore purchase, this is done offshore, typically in Bermuda where the major carriers do business. In addition, because a policy issued by an offshore carrier should have a foreign legal owner, it is necessary for the investor to establish a foreign trust or company to own the policy. Moreover, there are several important insurance design elements that must be carefully addressed in the acquisition process.

◆ **What will the policy beneficiaries receive when the insured dies?**

The income tax-free death benefit consists of the cash value of the policy (the premiums paid, plus growth, less account charges) plus the "risk" or pure insurance element. The insurance element generally will be minimized to the extent possible in the design process, and its amount will be determined with reference to U.S. tax rules. Insurance risk coverage in the offshore market is provided by the same reinsurance companies that reinsure the domestic life insurance market.

◆ **Are the insurance carriers that offer PPLI solid companies?**

There are a number of high quality carriers in both the domestic and offshore markets. Some of the offshore carriers are subsidiaries of large, well-known U.S. carriers, but there are also very small carriers that arguably should be avoided. Few offshore insurance companies have credit ratings in their own right. Some describe their claims-paying ability with reference to the ratings of their parents or principal reinsurer(s). Others have claims-paying guarantees from their parent company. Capitalization levels vary widely among foreign life insurance companies. Carrier due diligence is an important exercise in the policy acquisition process.

◆ **Where is the investment account of the policy located and is it safe?**

The separate account(s) of the policy will be custodied in accordance with the asset manager's normal custodial arrangement. Thus, in the case of an offshore policy purchase, there is no



requirement of offshore custody. The separate account of the policy is protected by law in the state or foreign jurisdiction where the insurance carrier is located from both the creditors of the insurance carrier. Whether the policy is protected against claims of the policy owner's creditors depends on a number of factors, including where the policy was issued and where the policy owner resides.

NOTE: This memorandum is for informational purposes only. It does not constitute an offer by Schurig Jetel Beckett Tackett or any other party to you or to any other person or entity to acquire a life insurance product.

***IRS Circular 230 Disclosure:*** To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained herein is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

