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FINANCIAL

Q&A
Private Placement Life Insurance

What is Private Placement Life Insurance?

Private Placement Life Insurance ("PPLI") is U.S. tax compliant variable universal life insurance that provides policyholders with virtually unlimited choices with regard to asset management. These products are filed with and approved by state insurance departments, but are exempt from registration under the Securities Act of 1933 and are not subject to regulation under the Investment Company Act of 1940.

Why are investors interested in PPLI?

Generally, the core motivation for acquiring a PPLI product is to establish an investment environment, at the lowest possible cost, in which the cash value of the policy can be invested in a separate account managed by an investor's preferred money manager(s). The death benefit component of the policy usually is considered a secondary benefit.

What are the U.S. tax advantages of life insurance?

The U.S. tax benefits include: (1) accumulated earnings (dividends, interest, and capital gain) within the life policy are tax deferred and, at death of the insured, tax-free to the policy holder; (2) the ability to withdraw and to borrow assets from the policy cash value free of income tax (with proper structuring); (3) the ability to exchange tax-free between the underlying investment options; and (4) the receipt of policy proceeds by the policy beneficiaries at the death of the insured on an income tax-free basis.

What is the main difference between PPLI and retail life insurance?

The policy owner has greater choices in designating the investment manager(s) and the investment mandate for the policy assets. Alternative Asset classes, for example hedge funds, are generally available. Because the earnings are not currently taxed, the policy holder does not receive a K-1. However, the policy owner cannot exercise direct control over the investment of the policy assets and there are diversification requirements, although they are not particularly onerous.

As discussed below, PPLI products generally have lower distribution and insurance charges and are therefore typically more competitive than retail insurance products. In addition to institutional pricing, the structure of and disclosure with PPLI provides transparency to the buyer and the seller.

PPLI products also do not typically have significant back-end surrender charges as many retail products do.

Who can purchase PPLI?

Only “Accredited Investors” and “Qualified Purchasers” can purchase PPLI. Generally, an Accredited Investor is a person with a net worth exceeding $1,000,000 or with an annual income of at least $200,000 over the past two years and a Qualified Purchaser is a person with a minimum of $5,000,000 of investments. Additional standards address ownership by Trusts and LLCs.

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 with regard to its tax treatment--if the product fails to qualify as life insurance under the applicable U.S. tax rules, the U.S. tax benefits are lost. Accordingly, it is critical to involve a highly knowledgeable and experienced private placement insurance professional (typically an insurance broker) 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. This may be paid in a single premium, or paid in stages over a period of time (typically four or five years). Payment of a single premium may result in a loss of tax benefits should the owner desire to access policy cash values during their lifetime.

What are the fees typically associated with PPLI?

Usually, there are three insurance related fees associated with PPLI products: the premium load, the "mortality and expense" charge, and the cost of insurance charge. The premium load consists of a state specific premium tax, “DAC” tax, and a charge for distribution related expenses. The premium load will vary, but typically will be around 1% of premium. The combination of the mortality and expense charge and the cost of insurance charge should average, over the life of the contract, around 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 medical and financial underwriting. There are several important insurance design elements that must be carefully addressed in the acquisition process. In some cases, an appropriate legal structure should be established for policy ownership.

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 insurance element of the contract. 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 for large face amount policies generally is spread among world-class reinsurance companies.

Are the insurance carriers that offer PPLI solid companies?

There are a number of high-quality carriers in the PPLI market, but there are also carriers that arguably should be avoided. Financial ratings may be provided by Standard & Poor's, Moody's, A.M. Best, and Fitch. With regard to addressing risk to the investment assets, however, it is important to note that the principal carriers do business in jurisdictions that have provisions in their laws that protect the separate accounts (i.e., the cash value) of these policies from the claims of other policy holders and from the carrier's general creditors.

File # 3079308.1