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Private Placement Life Insurance: A Cornerstone of Financial and Estate Planning for the High Net Worth Individual

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Successful advisors of high net worth individuals employ a top-down approach to their clients' planning, addressing all of the clients' goals simultaneously, rather than focusing on component goals in isolation. This approach requires the advisor to construct a plan that encompasses multiple areas of concern in a simple and understandable manner that meets clients' needs and recognizes the interrelationship of those areas. The advisor must consider investments, income taxation, estate taxation, asset security, and philanthropy in unison to achieve optimal results.

Private placement life insurance ("PPLI") provides a comprehensive solution to the planning challenges faced by advisors of high net worth individuals. As a product specifically developed for the investing and insurance needs of the high net worth individual, its mention is virtually mandatory in any estate planning discussion with such individuals. 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.

As an investment and income tax planning tool, PPLI enables access to sophisticated investment strategies used regularly by high net worth investors, such as hedge funds and hedge funds of funds, and reduces income tax liabilities, permitting such investments to grow income tax-free. Because PPLI is a life insurance product, it capitalizes on the income tax benefits of life insurance, which include: (i) tax-free accretion of investment earnings (dividends, interest, and capital gain) on policy assets; (ii) the ability, with proper structuring, to withdraw and borrow assets from the policy cash value free of income tax; and (iii) the income tax-free receipt of death benefit proceeds by the policy beneficiaries at the death of the insured.

As an estate planning tool, PPLI mitigates estate tax liabilities while facilitating the orderly disposition of assets at death. Most importantly, the death benefit proceeds of a PPLI policy pass to the policy's beneficiaries free of any federal income tax, and if structured properly, free of any estate tax. The liquidity provided from the policy's death benefit may be used to eliminate or mitigate the need to liquidate other family assets in order to pay estate tax. These proceeds can also be used as a powerful tool for augmenting a client's philanthropic goals.

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. However, the policy owner cannot exercise direct or indirect control over the investment of the policy asset.

· The policy purchasers must meet "qualified purchaser" and "accredited investor" guidelines under SEC rules.

· 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 highly than an otherwise after-tax return 6.5% (assuming a 35% tax rate applied on a 10% return).

PPLI is most often used as a simple, tax-efficient investment vehicle. However, by adding varying layers of complexity and employing competent counsel and advisers, PPLI should be a part of every high net worth individual's estate plan. Provided the policy remains inforce, the tax-free accretion of investment earnings, tax-free access to the policy assets, and tax-free death benefit, present an unparalleled planning tool that simply cannot be ignored by estate planners and wealth advisors to the high net worth community.

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