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Two liquidity life insurance options to help large estates handle difficult to market assets: static-priced no-lapse policies and market-priced no-lapse policies.

Life Insurance Solutions for Estate Tax Challenges

by Peter Katt, CFP, LIC

Although the estate tax (as of January) is in hibernation for the year, it will awaken in 2011. Large estates with difficult to market assets face a potential estate tax liquidity problem. Life insurance is ideal for this situation. (For a complete discussion of estate planning life insurance issues, see my November 2008 column in the *Journal of Financial Planning*.) There are two excellent liquidity life insurance options. Each has different potential advantages and disadvantages. These differences are not benign. They are potentially huge and depend on future events. Helping clients and advisers understand the differences is important so an informed choice can be made. In my experience, most insurance agents only recommend the no-lapse universal life (with lifetime guarantee) choice. This is a mistake. The following case study explains the two options and the differences.

The client, 57 and single, has a \$15 million estate represented by a fractional interest in real estate. Although the estate tax is in flux, it is believed that a credit equivalent of \$3.5 million and 45 percent tax rate will emerge. Based on this, her estate tax is \$5 million. This is the life insurance amount covered in this case study. The client is in excellent health and I assume she can qualify for preferred underwriting.

Of many options two are the most reasonable to consider. One of them I refer to as static-priced universal life (UL), and the other market-priced UL.

A few years ago, many life insurance companies developed and began selling universal life (UL) policies with no-lapse secondary guarantees based on paying specified premiums. I refer to these no-lapse policies as static priced. The premiums and death benefits are guaranteed—what you buy is what you get. We can think of this as term insurance for life.

Static pricing is in stark contrast to market pricing. A market priced policy's performance (and premiums) will depend on future fixed-income yields and mortality experience. Static-priced policies have low to no cash values, whereas market-priced policies have robust cash values.

Static-Priced UL—Acme Life

My review of static-priced policies indicates that Acme Life has good pricing relative to financial strength. A \$5 million policy has guaranteed annual premiums of \$52,827 paid every year. As with term insurance this is a simple deal—pay the \$52,827 and \$5 million death benefits are guaranteed lifetime. As noted below the cash values are low to zero compared with the market-priced alternative.

Table 1 shows Acme Life's financial strength ratings.

Table1 - Acme Life Financial Ratings				
Company	A.M. Best	Standard & Poor's	Moody's	Fitch
Acme Life	A+(2)	AA+(2)	Aa3(4)	AA(3)

Market-Priced UL—Premier Life

I believe the best option for market-priced UL is a low-expense Premier Life policy. The target premium for \$5 million coverage from Premier Life will change as the crediting rate changes. Based on the current 5.6 percent rate, the target premiums are \$65,359. I have estimated the target premiums based on various average crediting rates, shown in Table 2.

Table 2 - Premier Life Universal Life Target Premiums for Various Crediting Rates	
Average Crediting Rate	Target Premium
4.6%	\$76,000
5.1%	70,300
5.6%*	65,359*
6.1%	61,000
6.6%	56,000
7.1%	52,000
7.6%	48,000

* Current crediting rate and target premium

You will note that if Premier Life's crediting rate averages less than about 7.1 percent, the target premium will exceed Acme Life's static-priced guaranteed premium of \$52,827.

Table 3 shows Premier Life's financial strength ratings.

Table3 - Premier Life Financial Ratings				
Company	A.M. Best	Standard & Poor's	Moody's	Fitch
Premier Life	A++(1)	AAA(1)	Aaa(1)	AAA(1)

Cash Value Difference

Static-priced policies have little to zero cash values. In contrast, market-priced policies have robust cash values. There is a tremendous liquidity difference between the Acme Life static-priced and Premier Life market-priced options. Table 4 shows the cash value difference. The premiums for Acme Life are \$52,827 and \$65,359 for Premier Life.

Table 4 - Comparison of Premier Life and Acme Life Cash Values		
Age	Premier Life Cash Value	Acme Life Cash Value

57	\$38,186	\$0
61	299,125	0
66	687,083	53,405
71	1,150,154	170,408
76	1,668,408	229,581
81	2,210,190	0
86	2,715,523	0
91	3,189,190	0
96	3,645,674	0
100	3,997,881	0
Actual cash values depend on crediting rates		

Conclusion

This report demonstrates that there aren't right and wrong ways to buy life insurance. Each option has potential advantages and disadvantages. Some clients have a significant preference for one approach and would make their entire purchase in that manner. Others have split preferences and would mix the purchase among them.

- If you believe that fixed income yields will remain low for an extended period and cash value liquidity isn't important, Acme Life is the better choice.
- If you believe that fixed income yields will go up on a sustained basis and/or cash value liquidity is important, Premier Life is the better choice.
- I believe that maximum cash value liquidity is a very important characteristic of life insurance.

I am very comfortable that this client and her advisers know the important differences between static- and market-priced UL. I am also satisfied regardless of the decision that is made for the purchase of this liquidity life insurance.

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