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FAQs

How to Think Opportunistically in this Environment (Part 1 of 2)

In our first series of FAQs, the questions focused on how Covid-19 was impacting the life insurance companies. Recently, we have been receiving inquiries from both clients and advisors as to how to think opportunistically in this environment.

Interest Rates

Interest rate yields across all maturities are on or near all-time lows. How can a family take advantage of low interest rates for wealth transfer purposes?

The May 2020 long-term AFR is 1.15%. This historically low AFR creates opportunities for families to transfer funds to a trust outside of their estate with very "cheap" dollars. These funds can then be used to purchase assets that the trustee believes will appreciate over time. Any growth greater than 1.15% will remain in the trust and outside of the taxable estate and will not be subject to transfer taxes. Just to be clear, *the wealth transfer hurdle rate is 1.15%!*

Clients may purchase life insurance with a portion of the borrowed funds. But there are a host of wealth transfer ideas that are enhanced by the low interest rate environment. And, we encourage all of our clients to use this time to revisit their financial plans with their estate planning attorney, CPA and wealth advisor.

Private Placement Life Insurance/ Variable Universal Life

The stock market is down significantly for the year. Even if it drops further, I believe that the long term economic prospects are positive. Is life insurance an appropriate vehicle for investment purposes?

The Private Placement Structure allows investments in registered and non-registered funds. The VUL structure provides an investment platform comprised of funds that emulate a 401K platform.

In both instances, funds within the contract grow tax-deferred, rebalancing and reallocating funds are not taxable, the funds can be accessed without a taxable event, and all growth will be converted into an income tax-free death benefit.

If the policy is owned by an irrevocable trust, the death benefit will also be estate tax-free and the benefit will receive an effective step-up in basis. The question is simply: *Are the insurance costs are less than the taxes the policy owner would pay if the same strategy was executed in a taxable environment?*

Buffered Annuities

I want to be invested in the market but I am very nervous about further market losses. What can I do to protect against drawdowns, but still participate in a rising stock market?

There is no doubt that limiting losses from major market declines greatly improves wealth compounding and risk adjusted returns. Large drawdowns can be an investor's worst enemy. Not only is it difficult to recover performance after big portfolio declines, but setbacks foster anxiety that can lead investors to abandon long-term plans.

Buffered annuities offer clients "hard protection" against market index declines whereby the insurance company absorbs all losses up to that level while still offering potential compelling returns in rising markets.

Typically, the returns of the S&P 500 Index are used to determine policy crediting rates.

Recently, a client purchased an annuity with a 6 year investment segment tied to the S&P 500. The segment protected the client for the first 20% of the downside and also provided a 140% return to the upside (if the total gain was $100, the client would be credited with a gain of $140). The total annual cost for this investment contract is 95 basis points.