

M INTELLIGENCE

WHY YOUNGER COUPLES SHOULD CONSIDER SURVIVORSHIP LIFE INSURANCE

Survivorship life insurance is a powerful financial tool that can meet the changing long-term needs of young married couples. It is enduring enough to deliver traditional value by helping to fund future liquidity and legacy goals and flexible enough to help build supplemental retirement income. When combined with the growth potential of variable life insurance, the possibility of substantially increased cash value can make a couple's long-term goals even more achievable.

Quite simply, survivorship life is a second-to-die policy that pays out when both members of a couple have died. This design results in a lower cost of insurance compared with a single life policy, since the expected duration of the policy is longer. For younger insureds, these low mortality expenses can be highly attractive and make funding a policy designed to grow the death benefit over time very economical. The flexibility afforded by an accumulation-oriented policy gives clients options for a wide range of potential outcomes and objectives. Recent tax law changes governing life insurance make these uses more attractive than ever.

RIISING WEALTH AND RISING TAXES

Younger high-net-worth (HNW) couples' estates are likely to increase significantly in value over time, augmenting both wealth and corresponding tax liabilities. There is a strong possibility that these liabilities will reflect increased taxes, including estate taxes. This likelihood begs the question: "What can be done to plan for an increased estate tax

liability in the future, whether it reflects increased wealth, changed estate tax rules, or both?" Many survivorship life policies are designed to meet a current estate tax or defined liquidity need that is established at the time of purchase. If a couple has an estimated \$5 million estate tax, for example, then a \$5 million survivorship life insurance policy is often recommended to provide the needed capital for the beneficiaries to pay the tax cost. Planning for a liability further out in time requires a more flexible approach.

An attractive option could be to purchase a variable survivorship life insurance¹ policy and fund it so that the policy's death benefit increases if the policy's investment account achieves or exceeds a target rate of return. Since the account's investment returns accumulate on a tax-deferred basis inside the policy, the policy's account value can grow more efficiently.

To see how this works, a \$5 million policy issued on a 40-year-old male and female could be maximum-funded² with \$2 million of premium over the first

¹ A life insurance policy which allows the policyowner to invest the policy's account value in a variety of investment subaccounts.

² Represents the maximum premium allowed by the IRS to keep the policy classified as a Non-Modified Endowment Contract (Non-MEC) under The Technical and Miscellaneous Revenue Act (TAMRA) of 1988.

seven policy years. Based on a 6% net rate of return for the underlying investment allocation, the policy's death benefit could be projected to increase to \$17 million by the insureds' age 80 and \$26 million by their age 90 (**Figure 1**). This increase in death benefit could become a key component of the overall estate plan if the clients' net worth increases over that time or if legislative changes cause a larger estate tax expense than would be currently expected.

For a younger couple, a reasonable question is "What if I do not need that amount of insurance in the future?" The beauty of this policy design is that it's flexible enough to provide a clear answer. If a decision is made not to allow the policy's death benefit to grow and to recoup the premium payments, a loan could be taken from the policy after 10 years for the full amount of the premium payments (\$2 million). Even with the distribution of the premiums out of the policy, the projected death benefit would still equal \$8 million at age 80 and \$12 million at age 90.

SURVIVORSHIP LIFE POLICY AND SUPPLEMENTAL RETIREMENT INCOME

Life insurance is one of the few options to accumulate assets on a tax-deferred basis for individuals who have maximized their contributions to retirement plans such as a 401(k) or an IRA³, which have caps on the annual amount that can be contributed. Large insurance policy account values can supplement future retirement income needs, growing tax-deferred above and beyond those limits. A life insurance policy

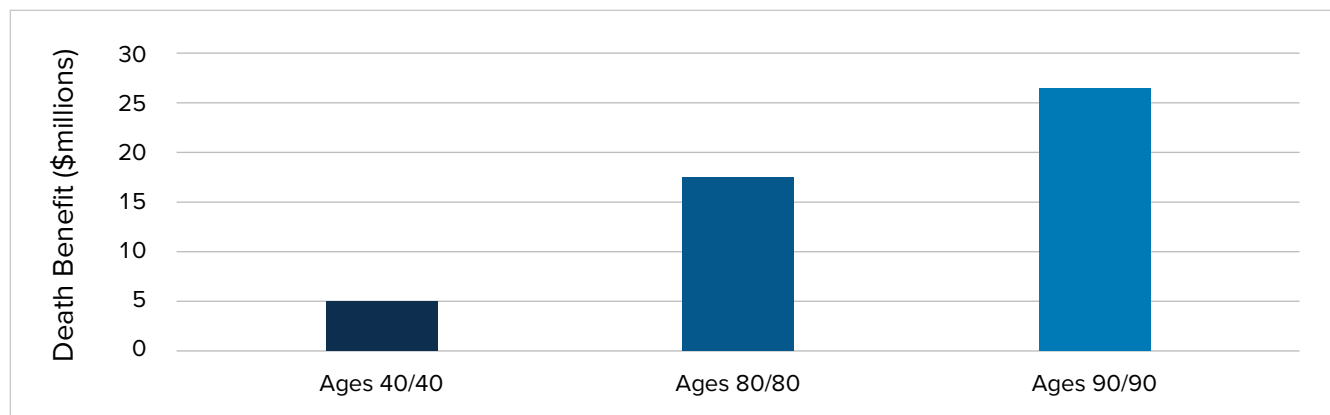
that is structured as a non-modified endowment contract (Non-MEC) allows withdrawals up to the policyowner's basis (premiums)⁴ and policy loans⁵ to be taken without incurring income taxes on policy gains.

In our example of a \$5 million variable life insurance policy funded with \$2 million of premium for a male and female aged 40, the policy was projected to provide a \$26 million death benefit when the insureds reach age 90. But if that same policy was purchased with the goal of providing a retirement income stream, under the same 6% net rate of return assumption it could provide \$335,000 in annual income for the insureds from ages 65 through 100. And because the policy is designed as a Non-MEC, that retirement income stream would be completely income-tax free. A minimal death benefit would remain intact. For perspective, this income stream is the pre-tax equivalent of \$530,000 per year for a client in the highest federal income tax bracket of 37%.

WHY VARIABLE UNIVERSAL LIFE?

A variable universal life (VUL) policy offers the widest possible choice of investment options, providing both flexibility and greater long-term potential returns. In addition to variable subaccounts, which offer access to a wide variety of asset classes, VULs have fixed account options to invest in the insurance company's general investment account. Many VULs also have indexed crediting rate accounts in which the annual interest credit is determined by the change in value

Figure 1. Projected Death Benefits of Max-Funded \$5 million Survivorship Variable Universal Life (SVUL) with 6% net investment return



³ Individual Retirement Plan

⁴ IRC §72(e)(3)

⁵ IRC §72(e)(5)

of an equity index over the preceding 12 months, such as the Standard & Poor's 500 index, subject to a minimum floor rate and maximum cap rate.

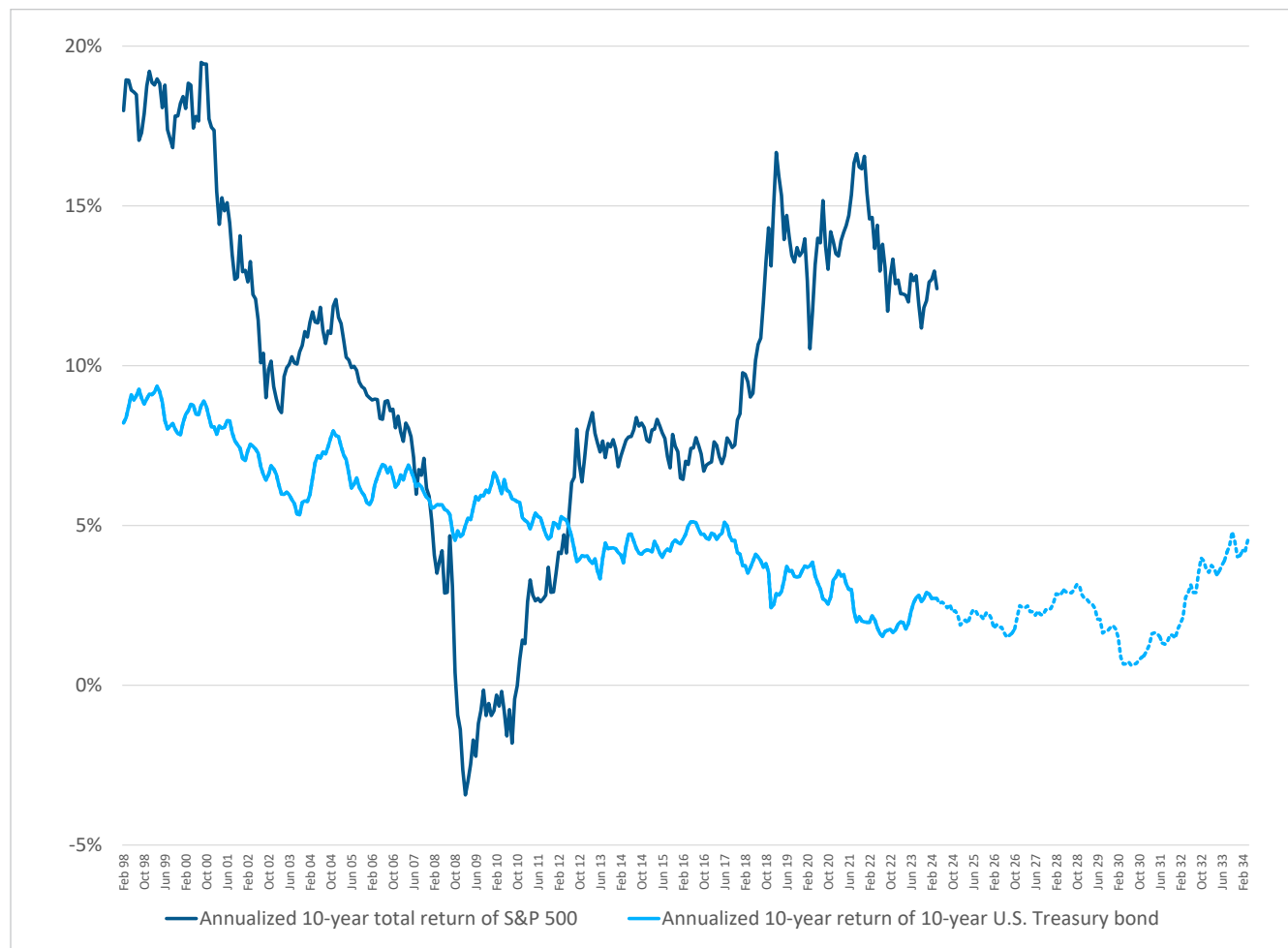
A couple at age 40 will have an estimated survivorship life expectancy⁶ of 45 to 55 years. This means the policy's investment time horizon, or the period of time an investor plans to own an asset, is approximately 45 to 55 years. This lengthy time horizon provides a significant capacity to endure volatility in investment returns. Equities have historically provided one of the highest long-term investment returns among asset classes but have also exhibited one of the highest levels of volatility⁷. Short-term volatility and a poor sequence of returns can significantly impact an investment portfolio, but

if an investor has a longer time horizon, the portfolio has a greater ability to recover from downturns in asset prices.

Figure 2 shows the 10-year annualized returns for the S&P 500 index⁸ and the 10-year U.S. Treasury bond as of the date on the horizontal axis. With the exception of the 10-year periods between January 1998–January 2008 and May 2002–May 2012, the return of the S&P 500 exceeded the return of the 10-year Treasury bond over the past 23 years.

Despite the recent rise in interest rates since 2022, the yield on U.S. Treasury bonds continues to be low as compared to the historical performance of U.S. equity markets. While Treasury bonds are considered to be one of the safest investments

Figure 2. 10-year Annualized Total Returns for the S&P 500 Index and the 10-year U.S. Treasury bond



Past performance is not a guarantee of future results. Sources: Standard & Poor's; U.S. Department of the Treasury

⁶ Life expectancy is the point at which there is a 50% chance that at least one of the two individuals will still be alive.

⁷ <https://www.investor.gov/additional-resources/general-resources/publications-research/info-sheets/beginners-guide-asset>

⁸ Including dividends

among all assets because the default risk is insured by the U.S. government, the rate of return is relatively low because of the safety of the investment. And the negative trend in interest rates over the past 40 years has resulted in the asset class exhibiting low returns as a trade-off for the safe investment risk. Equity returns are much more volatile, but the asset class historically provides greater returns than interest from Treasury bonds. Since policies dependent on a carrier's general investment account returns⁹ will exhibit performance correlated to interest rates, clients will find policies with equity-based investment choices better track equity growth over time.

Much like traditional asset allocation for retirement savings, policyowners of variable life insurance should also think about asset allocations for their policies. Younger policyholders have the advantage of an even longer time horizon than for traditional retirement savings, providing the opportunity for more aggressive investment strategies. This is because policy assets may not need to be accessed (in the case of the scenario addressing the need for a larger death benefit to address rising wealth) until the second death of the couple.

⁹ Policies such as fixed universal life and indexed universal life. Insurance company general investment accounts typically invest a majority of their assets in fixed income securities.

CHANGES TO TAX LAW GOVERNING LIFE INSURANCE

Section 7702 of the Internal Revenue Code addresses the rules applicable to life insurance. The Consolidated Appropriations Act, signed into law at the end of 2020, contained changes to the interest rate assumptions used in the tests concerning the definition of life insurance in §7702. Effective January 1, 2021, the required amount of death benefit for a given premium level to qualify as life insurance decreased dramatically for younger-aged clients. For example, a 40 year-old couple can now take out a policy with over 50% less death benefit that will still qualify as life insurance. This means that the cost of the insurance to fund a policy to achieve accumulation or retirement income objectives will be lower than it was prior to 2021.

SVUL: AN EXCELLENT, TAX-DEFERRED RESOURCE

An SVUL policy can be an excellent tool to accumulate assets on a tax-deferred basis. In an era where interest rates remain relatively low from a historical perspective, HNW younger clients with a longer time horizon can use the growth potential of SVUL to assist in accomplishing their financial goals including saving for retirement.

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Variable life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and entails risks, including the possible loss of principal.

Variable Universal Life insurance combines the protection and tax advantages of life insurance with the investment potential of a comprehensive selection of variable investment options. The insurance component provides death benefit coverage and the variable component gives you the flexibility to potentially increase the policy's cash value.

Investments in securities involve risks, including the possible loss of principal. When redeemed, shares may be worth more or less than their original value.

Past performance is not a guarantee of future results. Examples showing index performance are for illustrative purposes only: an investor cannot invest in an index. Death benefit guarantees of variable life insurance products are subject to the claims-paying ability of the insurance company.

Loans and partial withdrawals will decrease the death benefit and cash value and may be subject to policy limitations and income tax.

Investors should consider the investment objectives, risks, charges, and expenses of any variable life insurance product carefully before investing. This and other important information about the investment company is contained in each product's prospectus. Please read it carefully before you invest.

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