PRIVATE PLACEMENT LIFE INSURANCE

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Know your story.

The Essential PPLI Handbook:

Simplifying Private Placement Life Insurance for Advisors and Clients

By Ben Rainey and Aidan Elliott

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Over my 20 plus year career in life insurance, I had often heard of Private Placement Life Insurance (PPLI) but had never taken the time to understand it.

Like many insurance advisors, and other professionals, I thought it was overly complicated and unnecessarily confusing. And yes, while the product was cheaper than traditional life insurance, the investments with which I was familiar were limited and often underperformed.

Nothing about PPLI seemed compelling.

All that changed during the early days of COVID in 2020. With extra time on my hands, and at the urging of my good friend and business partner at the time, Aidan Elliott, I dove headfirst into understanding this mysterious product.

What I discovered astounded me.

Everything wealth managers, CPAs, and attorneys dislike about traditional life insurance – the confusion, lack of transparency, poorly aligned incentives – gone. The previous limits on investment choices and underperforming funds – also gone. Plus, PPLI is now 50% less expensive than when I first heard of it a decade or so ago!

The beauty of PPLI is that it is elegantly simple.

With PPLI there are no proverbial bells and whistles or complicated tax loopholes. It simply marries institutionally priced life insurance with professional asset management.

Due to advisors' and clients' prior experiences, PPLI can still be seen as a complex and confusing strategy. It need not be so. It is my hope that this handbook helps demystify this often overlooked and yet exceedingly powerful planning tool.

PPLI truly is a game changer and I'm grateful you're taking the time to better understand it.

Ben Rainey

What Is PPLI?

By Ben Rainey and Aidan Elliott

"The Most Powerful Force in the Universe is Compound Interest"

-Albert Einstein

Private Placement Life Insurance (PPLI) is an institutionally priced variable life insurance product that ultra-affluent individuals use to mitigate income taxes on a portion of their investment portfolio. It is designed so that the investment account of the policy is managed by the policyowner's professional investment advisor.

Like all life insurance policies, assets inside PPLI enjoy tax-deferred growth. With proper design and servicing, the policyowner can also enjoy tax-free access to those assets at any time. Additionally, PPLI pays out a tax-free death benefit when the insured passes away.

It sounds like a wonderful tool. Yet, since its creation in the late 1970s, PPLI has been the "Bigfoot" of the insurance and asset management industries. Many advisors and their clients have heard about it and know it exists, but very few have seen a PPLI policy implemented. In recent years however, it has become increasingly utilized by advisors to the ultra-affluent for three primary reasons.

The first is that PPLI is one of the last tax-deferred structures that can be used in planning with minimal contribution limitations. As tax rates have continued to increase, this tax-deferral has become more and more attractive. The second reason is that PPLI can integrate into all existing long-term wealth transfer planning, making it straightforward and seamless to implement.

Perhaps the biggest reason that PPLI is more commonplace today is because of the separately managed account (SMA). The SMA allows an investment professional to manage the money inside of a PPLI policy just as they would in a regular taxable taxable account.

How the SMA Changed Everything

Since its inception, PPLI has been understood as an effective place in which to own tax-inefficient investments – namely hedge funds and credit strategies. These funds were pre-packaged and sold on a menu basis and are commonly known as insurance dedicated funds (IDFs). While many of these funds are excellent and have name brand managers, for example Bain, Golub, Millennium, etc., the strategy is not in line with how money is managed today. Most ultra-affluent clients do not like being forced to choose from a predetermined list of investment choices. They chose their investment advisor because of their investment platform and offerings, not an insurance

carrier's. Additionally, most investment advisors today create custom portfolios for their clients and don't have time to research a whole new set of IDF offerings.

Enter the SMA. Now investment advisors can open an account with their current custodian and manage the money inside the PPLI policy with nearly unlimited investment options. Anything from private equity, hedge funds and venture capital to real estate, index funds and corporate bonds can be owned within the SMA.

In our minds, this is the holy grail for both the client and the investment professional. Now the PPLI policyowner can have the custom investment management they desire along with all the tax benefits of life insurance.

How is PPLI Different From Retail Life Insurance?

In the eyes of the IRS and the tax-code, PPLI is simply a variable universal life (VUL) policy. As such, PPLI complies with all the relevant tax code sections that apply to all life insurance – most notably section 7702 which establishes and defines the specifics of a life insurance contract.

What makes PPLI unique and attractive to ultra-affluent investors compared to VUL is the types of investments that they can now own inside the policy, and how the policy is priced. Life insurance agents and brokers that sell PPLI do not receive a heaped commission as with traditional products, but rather receive small fee-based compensation. The policies are completely transparent in terms of fees and costs. The owner can see exactly what the product will cost each year, and to which party these costs flow. As a rule of thumb, the cost of a properly designed PPLI contract will run between 0.30% and 1.00% over the life of the insured.

The Math

It is a truism that "it's not how much money you make, but how much you keep that matters" and PPLI enables our clients to keep more of what they make. The math is simple: the cost of insurance is significantly less than the cost of taxes, and over time the cost savings compound to the policyowner's benefit. The longer a client has that math compounding in their favor, the more favorable the outcome.

For an average 50-year-old male, our analysis shows that given the exact same investment returns, a PPLI account may result in twice as much account value over a 40-year period as compared to a typical taxable account.

Summary

PPLI is not for everyone, but for qualified ultra-affluent clients looking for income-tax relief, we think it is a powerful solution. Our belief is that Albert Einstein was only partially correct. With apologies to Mr. Einstein, we would respectfully assert that the most powerful force in the universe is compound interest without taxation!

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Solving the Income Tax Problem

By Ben Rainey and Aidan Elliott

"People screen out a lot of commercials because they open with something dull. When you advertise fire extinguishers, open with the fire."

-David Ogilvy

Life insurance is often a dull subject at the best of times, yet it offers many exciting tax benefits via the U.S. Internal Revenue Code. These benefits include tax-deferred growth, the potential for tax-free access of the underlying cash value during a client's life and a tax-free payment of the death benefit.

PPLI is afforded all the same tax benefits as traditional life insurance and is designed for investment performance, not maximum death benefit. Therefore, with prudent planning, PPLI can be used to mitigate some of the taxes assessed on a client's investment portfolio annually.

The advantage of PPLI is the function of a simple equation: is the cost of the insurance less than the cost of the taxes on the investment portfolio? In evaluating suitability, it is imperative to calculate the annual tax projections of a current investment portfolio and compare against the cost of insurance annually.

The Problem – a Third of Investment Return Lost to Taxes Annually

Consider a 50-year-old Arizona resident with no life insurance in place. His current investment portfolio is outlined in the table below and he desires tax-relief on $20 million of his liquid investment portfolio that is held in a family trust. His investment risk tolerance is high and the projected rate of return on his portfolio based on long term capital market return assumptions is assumed to be 7.93%.

Current Portfolio - Tax Treatment

Assumptions

State	AZ	Federal	State	NIIT	City
OI/STCG Tax Rate*	43.30%	37.00%	2.50%	3.80%	0.00%
LTCG Tax Rate	26.30%	20.00%	2.50%	3.80%	0.00%

Portfolio Allocation	Investment Allocation	Investment Balance	Investment Assumption	Assumed Tax Treatment	Assumed Turnover	Assumed Tax Rate*
Ares Fund	25.00%	$5,000,000	**8.00%**	Blended Rate (100% OI; 0% LTCG)	0.00%	43.30%
Golub Fund	17.50%	$3,500,000	**9.00%**	Blended Rate (100% OI; 0% LTCG)	0.00%	43.30%
StarFire Fund	15.00%	$3,000,000	**6.00%**	Blended Rate (30% OI; 70% LTCG)	10.00%	14.83%
Private Equity Fund	30.00%	$6,000,000	**9.00%**	Blended Rate (80% OI; 20% LTCG)	15.00%	35.43%
Equities	12.50%	$2,500,000	**6.00%**	Blended Rate (20% OI; 80% LTCG)	5.00%	9.71%
Total/Weighted Average	100.00%	$20,000,000	7.93%			32.29%

Assumes the tax treatment of each fund, factors in the marginal ordinary and long-tern capital gain tax rates and frequency of when they are incurred/realized

If the client were to maintain his existing investment allocation in a taxable account, he will lose roughly 32.47% of his investment return annually to taxes. This translates to a 2.56% net loss to his investment return every year.

After undergoing medical underwriting, the client has secured a preferred underwriting classification and will pay 0.62% (all program fees included) annually in life insurance costs to secure and maintain a PPLI policy over his lifetime.

Benefit

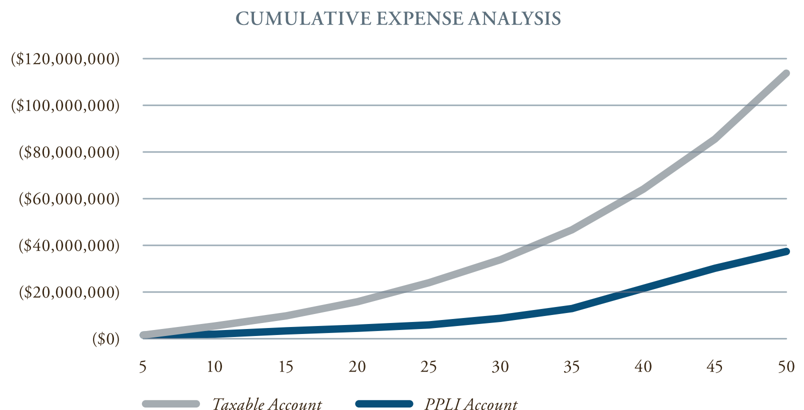
In this example, the impact of PPLI is measured by swapping 2.56% in tax costs on his investment portfolio for 0.57% in insurance costs.

The below table illustrates the tax friction of keeping the $20 million invested in the client's taxable account compared to the costs of the PPLI product over the next 40 years. Over this 40-year holding period he will save just under $64 million in taxes compared to paying just over $19 million in insurance costs for a total cost savings of over $44 million that compounds to his benefit each and every year.

Cost of Taxes vs. Cost of PPLI Structure

Year	Taxable Account Cumulative Cost	PPLI Account Cumulative Cost	PPLI Account Cumulative Cost Savings
5	($2,228,463)	($1,126,792)	$1,101,672
10	($5,742,613)	($1,951,563)	$3,791,050
15	($10,306,424)	($2,986,952)	$7,319,472
20	($16,233,425)	($4,553,051)	$11,680,374
25	($23,930,795)	($6,163,507)	$17,767,288
30	($33,927,334)	($8,290,813)	$25,636,521
35	($46,909,796)	($11,963,158)	$34,946,638
40	($63,770,061)	($19,286,168)	$44,483,893
45	($85,666,41)	($29,268,104)	$56,398,309
50	($114,103,106)	($34,763,188)	$79,339,918

- *Brokerage expenses consist of all income and capital gains taxes incurred*
- *PPLI expenses consist of premium tax charge, structuring fees, M&E charge and COI*
- *Investment management fees are assumed to be the same for both the brokerage and the PPLI assets*



Summary

Not many firms take the time to understand the taxable account tax problem, nor communicate it clearly and concisely to their clients. By starting with the tax problem and then highlighting the value that PPLI adds, we believe our clients and their advisors are better positioned to confidently implement this powerful tool.

"The advantage of PPLI is the function of a simple equation: is the cost of the insurance less than the cost of the taxes on the investment portfolio?"

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Potential Impact

By Ben Rainey and Aidan Elliott

"Strategy is about making choices, trade-offs; it's about deliberately choosing to be different."

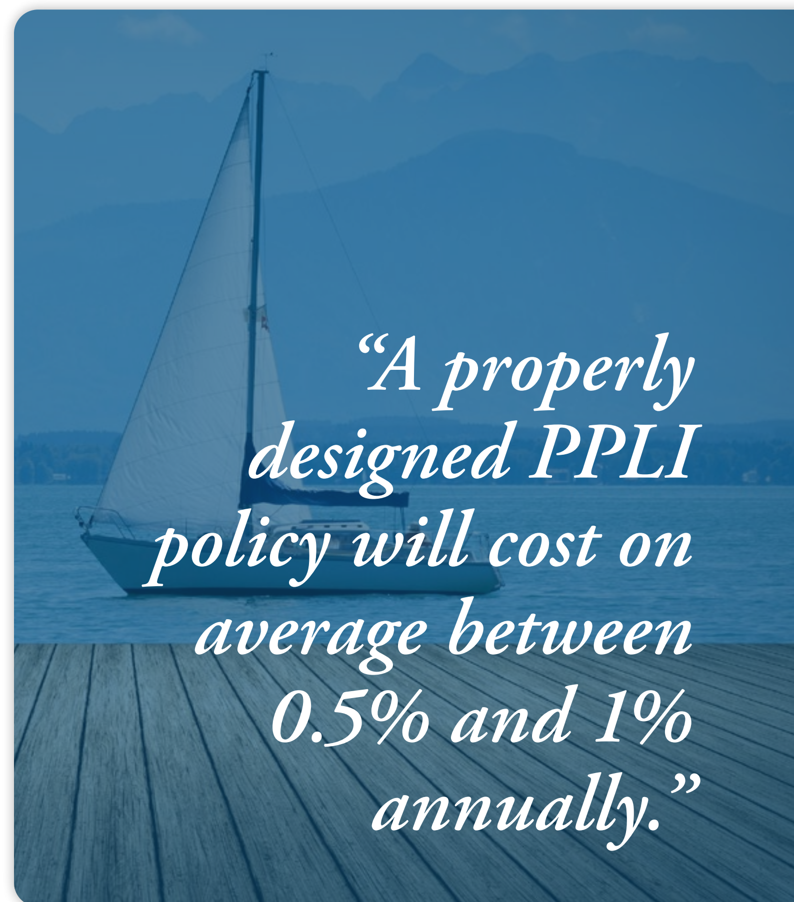
-Michael Porter

Understanding the potential impact of investing inside a PPLI policy versus investing in a taxable portfolio can be difficult because each contract owner's circumstances are different. In other words, the outcome differs for each contract and depends upon the age, health and sex of the insured, insurance company costs of insurance, mortality and expense charges, insurance broker compensation and actual investment performance.

A properly designed and administered PPLI policy will cost on average between 0.5% and 1% annually. As noted in chapter two – "The Tax Problem", our client's costs were 0.57% a year. By comparison, the tax expense on most high-net-worth individuals' portfolios is substantially higher. It is not uncommon for the annual tax drag to be close to 2% to 3% or more. It is for this reason that we spend so much time with our clients and their advisors to understand their specific tax situation.

Simply put, if an individual is paying more than 0.5% to 1% in portfolio generated income taxes, PPLI can make a substantial, positive impact on their balance sheet. Additionally, the longer the time horizon over which to compound returns inside PPLI, the more favorable the potential returns may be.

Revisiting our base case from chapter two the below table compares the account balance and internal rate of return (IRR) benefit of investing in a PPLI policy in lieu of a taxable account over a 40-year period.



Taxable Account vs. PPLI Account at Year 40

Account	Total Investment	Account Balance	Account Balance IRR
Taxable	$20,000,000	$153,738,558	5.37%
PPLI		$319,144,344	7.36%
PPLI Advantage		**$165,405,786**	**1.99%**

Outcome

Investing $20 million in a typical taxable account will result in an ending balance of around $153 million dollars after 40 years – a terrific result. However, that same $20 million invested inside a PPLI account would grow to over $319 million dollars in the same period. That is an improvement of $165 million or a return of more than 100%!

Remember, an individual can invest in exactly the same assets inside PPLI as in a typical taxable or managed account. The principal difference between these two vehicles is that the owner is electing to pay insurance charges in lieu of taxes. Instead of paying 2.56% a year in taxes, 0.57% is paid in insurance fees and expenses adding 1.99% in annual compounding benefits. We call this "locational alpha."

Summary

Having a superior strategy leads to successful outcomes. As Michael Porter, founder of the modern strategy field asserts, strategy is all about making trade-offs as is true of PPLI. In trading income taxes for PPLI insurance costs, the investment portfolio will retain a greater return.

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PPLI and Access to Your Money

By Ben Rainey and Aidan Elliott

"Rational investors will part with their cash only when they believe they are properly compensated for the loss of liquidity and the pain of disquietude."

-Peter Bernstein

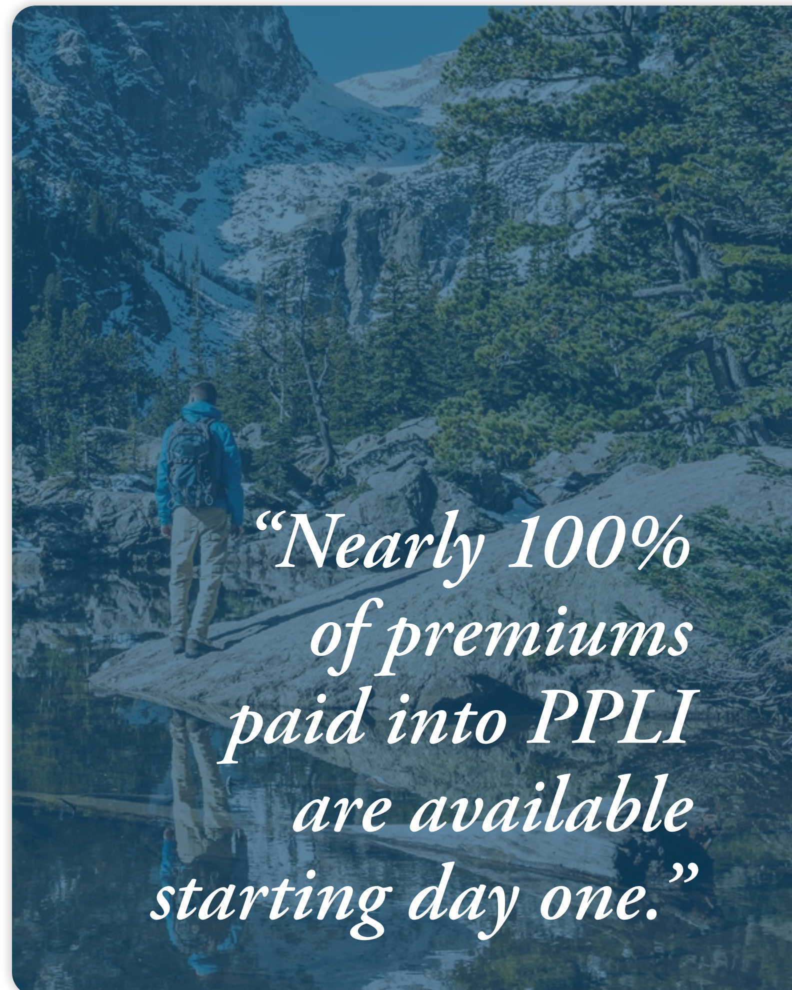
With most retail life insurance products, it is recommended to wait several years before distributing any funds. This is largely due to the up-front commissions, fees and other expenses that are levied on traditional life insurance. In contrast to these retail insurance products, PPLI does not have large up-front fees and expenses. Also, because there are no insurance broker commissions with PPLI, there are no surrender charges. As a result, nearly 100% of premiums paid into PPLI are available starting day one and access to funds is simple and straightforward.

We often reference how Fidelity Investments revolutionized the money market mutual fund game back in the late 1970s. Fidelity was the first to allow account holders to write checks against their money market funds and allow for next day liquidity. Prior to this innovation, it took several days and sometimes weeks for funds to become available to account holders. This liquidity innovation resulted in a flood of new funds into Fidelity and served as a significant springboard for much of their growth at the time.

The PPLI account operates in a similar way. If clients truly understood that they had access to their funds in the account at any time, and that the cost to access the funds was nearly zero, we believe they would put a lot more of their liquid assets into the account.

Keeping Things Simple

The simplest way to think about accessing money from a PPLI account is to think of it as a two-way Roth IRA with no age or income limitations. The money inside the account grows tax-deferred and the policyowner can take the money out at any time. Clients can access the funds in their PPLI accounts just like they would in any other account. The investment advisor simply sells the necessary positions to generate cash in the portfolio and then this cash is made available to the policyowner via a policy withdrawal or loan.



Policy Withdrawals

Withdrawals from PPLI are tax-free up to the basis of the policy. Account holders can get back their premiums, minus fees, without any tax consequence.

Policy Loans

Account holders can borrow against the cash value of the PPLI policy with no underwriting or credit check. The loan is secured by the policy's cash value. The loan does not have to be paid back, though the policyowner may want to replenish funds borrowed from the policy to maximize the long-term tax-free growth that the assets in the account are afforded.

Because the loans are secured by payments already made to the insurer, interest rates are very low. Borrowers should be aware that interest does accrue and borrowing will reduce any death benefits paid out unless the loan is paid back to the policy.

The cost of the loan is fixed and contractually guaranteed and varies depending on the insurance company. Typical loan costs are in the 0.05% to 1% range annually. Depending on the insurance company, a policyowner can access between 85% - 90% of policy account values, including all gains, completely tax free at any time.

The PPLI Difference

Going back to our case study in chapter two – "The Tax Problem", our client desired access to money from his PPLI account 10 years after initially funding it with $20,000,000.

Example - $20,000,000 Investment				
Account	Projected Balance	Liquidity Need	Cost of Liquidity*	Balance After Withdraw
Taxable	$32,043,407	$4,000,000	($362,729)	$27,680,679
PPLI	$36,788,883	$4,000,000	($2,000)	$32,786,883

**5BPS per Prudential contract used for PPLI*

The chart above shows how the original $20,000,000 would have performed in a taxable account versus the PPLI account. What this demonstrates is that his $20,000,000 taxable account would lag the PPLI account in year 10 by over $5,000,000. In addition, the cost of accessing the funds for this liquidity need was significantly more than accessing cash from his PPLI policy. The cost of liquidity from his taxable account is the tax he would incur from selling positions to generate the cash needed. The cost to access $4,000,000 of funds from his PPLI account is the loan cost of 5bps – or $2,000 per year as long as the loan is outstanding.

Summary

Keeping Peter Bernstein's quote top of mind, we agree that rational investors will only part with their hard-earned dollars if they are adequately compensated for any loss of liquidity. Thanks to its favorable characteristics, there are few liquidity restrictions associated with a PPLI account. In fact, it can serve as a potentially tax-free bucket from which to source funds for any type of liquidity need.

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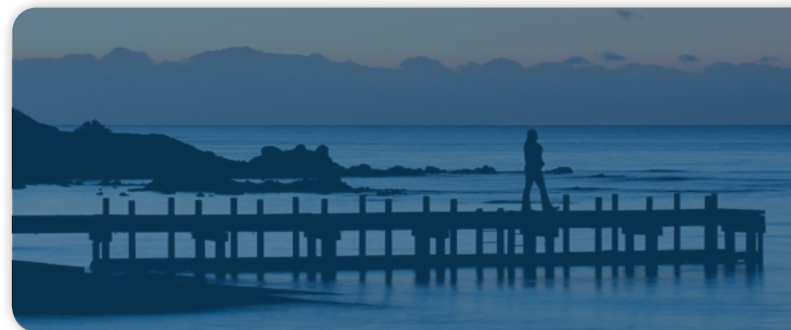
PPLI in Estate Planning – Trusts and Step-up

By Ben Rainey and Aidan Elliott

"Football is two things. It's blocking and tackling. I don't care about formations or new offenses or tricks on defense. You block and tackle better than the team you're playing, you win."

-Vince Lombardi

One of the more significant "Aha!" moments for our clients and advisor partners is when they grasp the total tax implication of implementing PPLI within irrevocable trusts. Many estate plans use both grantor and non-grantor trusts for their well-known estate tax benefits. They come in various shapes and sizes and are called by a slew of acronyms – SLATs, GRATs, CLATs, ILITs, IDGTs and more. No matter the acronym, all have significant estate tax benefits.



As with almost anything in life, there are trade-offs. Trusts carry with them a couple of significant negative tax problems that otherwise complicate these useful structures as follows:

Grantor Trust Tax Problem

Properly structured grantor trusts are great tools for avoiding estate taxes upon death and for providing a host of other benefits. However, during the lifetime of the grantor there is a consistent and ongoing problem – annual income taxes. Gains in the trust are taxed to the grantor. Some people refer to this as a "phantom income tax." The gains are there but the person paying the tax did not benefit from them.

Most practitioners view this as a good thing and we generally agree. It functionally allows the grantor to pay taxes on behalf of the trust (in what amounts to additional tax-free gifts to the trust) and further allows the trust assets to grow more quickly. However, there can be a point in time where the annual income tax burden is so significant that it may start to impact the grantor's lifestyle. In most cases when this happens, the grantor provision is merely "toggled off."

The trust then becomes a non-grantor trust, but the income tax does not mysteriously go away. The annual income tax burden is shifted to the trust.

Non-Grantor Trust Tax Problem

In a non-grantor trust, the trust is the income tax payor. Any gains attributable to trust assets trigger income tax, just like they did for the grantor in the previous example. Unfortunately, the effective tax-brackets for trusts are very high. For most of our clients' trusts, they are in the top income tax bracket nearly immediately.

Annual taxes paid by the trust erode the trust assets unnecessarily and eat into the value that is ultimately going to the beneficiaries of the trust.

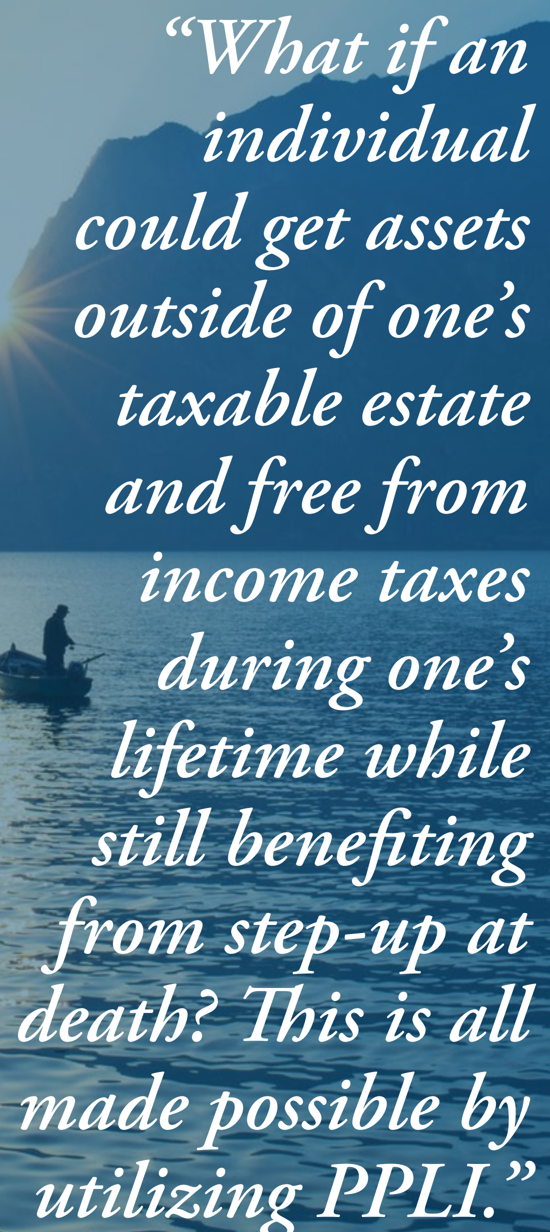
Lack of Basis Step-Up Problem

No matter the trust type (grantor or non-grantor), or what variety you are using (SLAT, GRAT, etc.), a trust does not receive a step-up in basis at death on any of the assets it holds. Any assets held with any unrealized gains will have a capital gains tax due at some point. This tax is not realized until the asset is sold, often years after the grantor's generation has passed, but it is a tax that is due and will be paid at some point. For many trusts, these deferred gains are substantial.

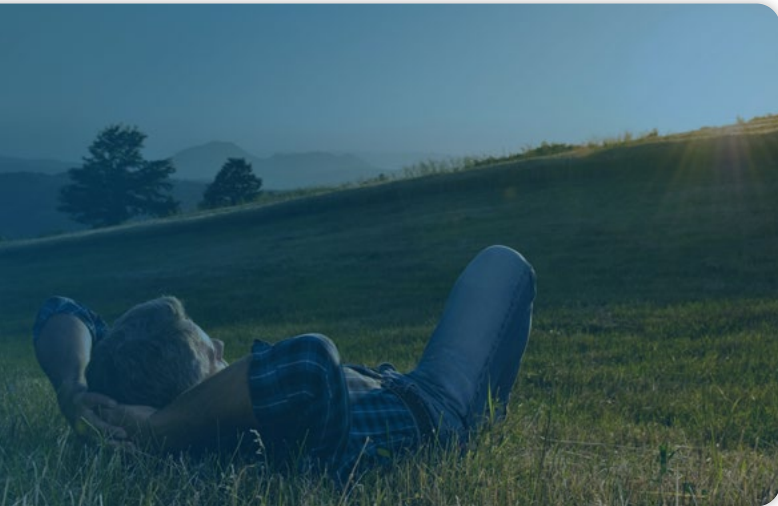
To combat this, many trusts offer a substitution of assets as a provision. This is often referred to as "basis shifting" and it is a strategy used frequently in estate planning. It means that one can swap assets of equal value in and out of the trust. While basis shifting does potentially alleviate the problem of lack of basis step-up for trusts, it must be administered and papered properly. What is more, death is not predictable and asset swaps often cannot be completed in time.

Problem Solved – The "Holy Grail" of Tax Planning

Most people know of these income tax and basis step-up issues, but the overall planning goal of eliminating the estate tax are worth the issues. What if there were a way to achieve everything in one? A "Holy Grail" of income, step-up and estate tax planning combined. What if an individual could get assets outside of one's taxable estate and free from income taxes during one's lifetime while still benefiting from step-up at death? This is all made possible by utilizing PPLI.



As most professionals know, PPLI (and all forms of life insurance for that matter) enjoys tax-favored IRS status. All income and capital gains inside the PPLI account grow tax-deferred during the insured's lifetime, and with proper planning, all those gains can be accessed tax-free. PPLI can clearly solve the income tax problem.



What many professionals fail to recognize is that PPLI effectively creates a "step-up" in basis at death. When an insured dies, the insurance policy pays out the death benefit in a tax-free payment of cash. This death benefit includes the underlying assets inside the PPLI account plus the pure insurance in the contract – the death benefit is always more than the underlying PPLI investment account values. All gains in the account are effectively "stepped-up" at the moment of death through this payment of a tax-free death benefit.

"Aha!" indeed!

As an aside, some assets inside the PPLI account, such as private equity or other illiquid positions, can be paid out in kind, but this too will be treated as a tax-free death benefit and the basis adjusted accordingly.

Summary

Vince Lombardi correctly believed that a combination of superior blocking and tackling wins championships. This same philosophy can be applied when it comes to advanced estate planning. Our clients adopt a Lombardi approach of simultaneous blocking and tackling with their tax planning. They move significant assets out of their taxable estate and into trusts. Once inside those protected structures, they move significant assets into PPLI policies to add additional protection from the degradation of income and deferred capital gains taxes. It is the ultimate winning strategy.

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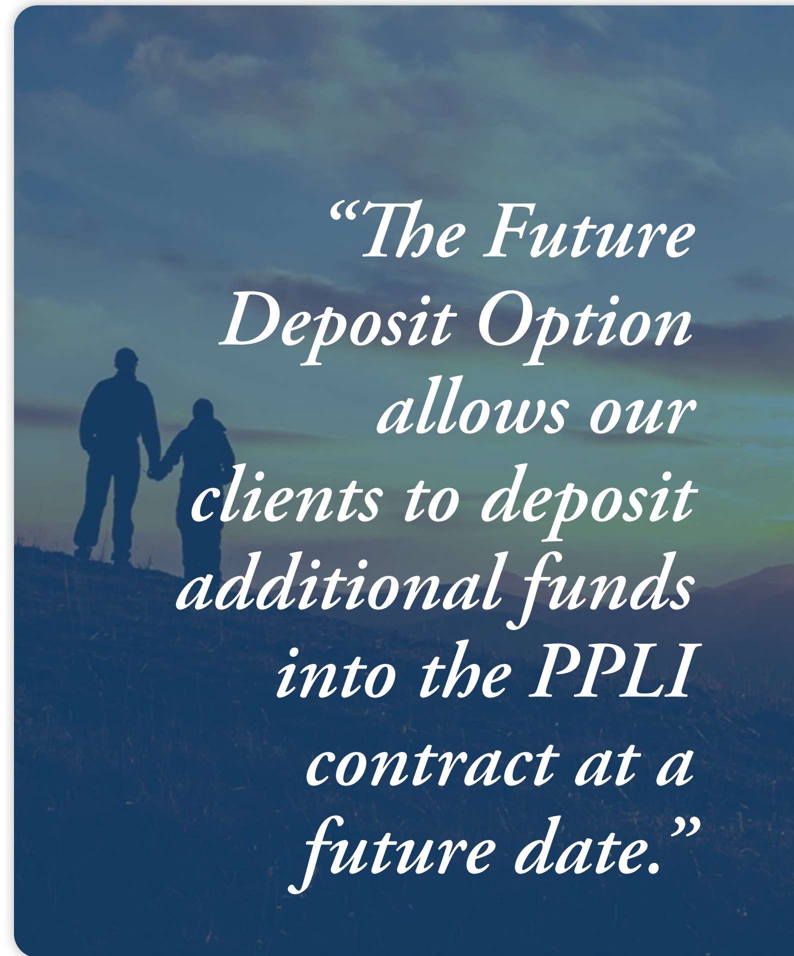
By Ben Rainey and Aidan Elliott

"Don't test the depth of a river with both your feet."

-African proverb

Many individuals love the idea of PPLI, but often due to prior experiences, they are skeptical of insurance. As a result, while clients believe that PPLI is a prudent concept to implement, they are reticent to commit significant percentages of their portfolio until they see it in action. Because of this initial and understandable skepticism, we have developed a Future Deposit Option (FDO) that allows the PPLI owner to deposit additional funds into the contract at a future date. We will explain what that is and how it works later in this chapter, but let's begin with why it's necessary in the first place.



Life insurance is tax-favored in the Internal Revenue Code and as such there is a limit to how much money can be paid into an insurance contract per death benefit dollar. In insurance lingo, it is called the 7-Pay MEC test and was passed into law back in the 1980s under code section 7702. We design PPLI policies to accept the maximum legal amount of premiums into the policy while maintaining tax-favored status.

For most people this is a conundrum. They are used to paying the lowest possible premium for life insurance. But in PPLI, we want to do the exact opposite. We want to contribute the most dollars into the contract as quickly as possible while buying the least amount of insurance we can. This creates the most efficient cash value accumulation, but this also creates a potential problem.

If we design the PPLI account to be funded at the maximum dollar level, then the policy cannot accept any more deposits at any point in the future. For the client taking a conservative approach and allocating 10% of their portfolio to PPLI, this limits their ability to add funds later without having to purchase an additional policy. That new policy would require new underwriting, a medical exam, a different account at their custodian, incremental cost and so on.

The FDO allows our clients to deposit additional funds into the PPLI contract at a future date without the hassle.

How it Works

Say we have a client who wants to put $5,000,000 into their PPLI account today. The client also anticipates significant liquidity in the coming five to seven years and would eventually like to take advantage of investing those proceeds in a tax-free PPLI account.

This is where the FDO comes in to play.

During policy design, we schedule additional policy premiums (deposits) equal to the amount of anticipated liquidity. This design gives the client the option, but not the obligation, to make those future deposits. Should the liquidity event not occur, the payments to the policy do not have to be made. In contrast, this does obligate the carrier to accept the premiums with no further underwriting required. The FDO can be scheduled to take the entire deposit in one year, or it may be spread out over multiple years to accommodate for the variability in the timing of anticipated liquidity.

Most of our designs for PPLI include a PPLI FDO. The amounts vary, but they are often equal to the initial premium deposit and sometimes as much as two or three times more.

Cost of the FDO

One of the main considerations in designing a PPLI policy this way is the cost. Adding money in future years requires the life insurance death benefit to be higher than it would be otherwise. This increases the cost to the policyowner. The good news is that the cost for holding the additional death benefit is not significant.

As an example, consider John Smith, a local entrepreneur. John likes the idea of PPLI and is anticipating a future sale of his business in the next five to seven years. John currently has a liquid portfolio of $20,000,000 and has decided to allocate $5,000,000 of that to PPLI. He would like to consider adding more to his PPLI policy as the value of his assets grow and as he has additional liquidity from the sale of his business.

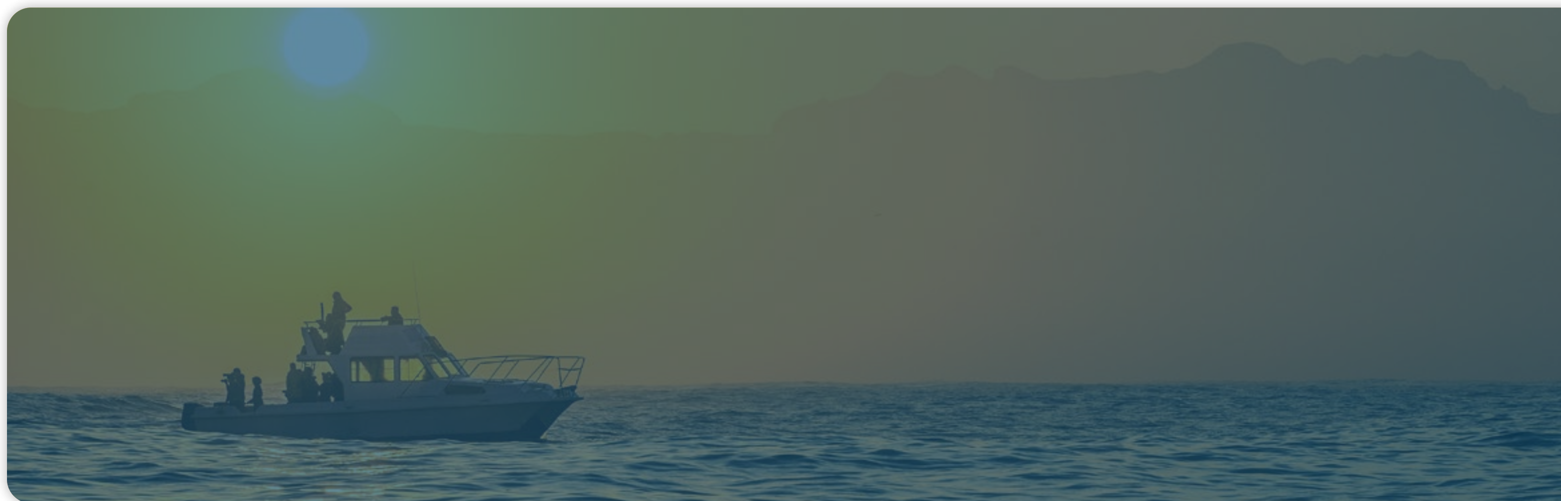
Our standard PPLI design would call for $5,000,000 to be paid into PPLI over three years. With this design we would then add an additional $5,000,000 to be deposited starting in year five. To account for some variability in the timing of the sale of his business, we spread the additional $5,000,000 PPLI deposit over a three-year period. This allows him to pay an additional $1,667,000 into his policy in years five, six and seven. He cannot accelerate those payments, but any payment that he does not make, can be "caught up" in future years.

The chart below shows the costs and benefits of the FDO for John.

Cost Summary - Future Option			
Initial Investment: $5,000,000 Future Investment Option: $5,000,000 Assumed Annual Return: 9.10% Gross			
Design	Cost of PPLI Account	+/–	Net to Heirs IRR at Year 40
Original $5m Design, Optimally Funded	62bps	N/A	8.48%
With $5m Option, Funded	57bps	-5bps	8.53%
With $5m Option, Unfunded	65bps	+3bps	8.45%

The top line in the chart is the industry standard PPLI design. That design would cost John 62bps over his lifetime. If we added the FDO and he was unable to fund it at all (the bottom option above), that would increase his costs on the contract over his lifetime by 3 basis points.

If he makes those deposits as scheduled, adding pre-miums, the policy hits internal cost breakpoints earlier and ultimately saves him money. The overall cost over his lifetime drops to 57bps. More importantly, John can protect a total of $10,000,000 from taxation in this design, instead of just $5,000,000. This doubles the impact of the PPLI account and the benefit to him and his wife, and ultimately their heirs.



Summary

We are keenly aware of the African proverb encouraging us to not jump into a new endeavor or strategy without thoroughly understanding or feeling confident in its utility. Therefore, we created the FDO design for PPLI. It allows our clients to add funds comfortably and confidently to their tax-advantaged PPLI account down the road and skip the uncertainty of a large up-front commitment and/or the hassles of a second PPLI account.

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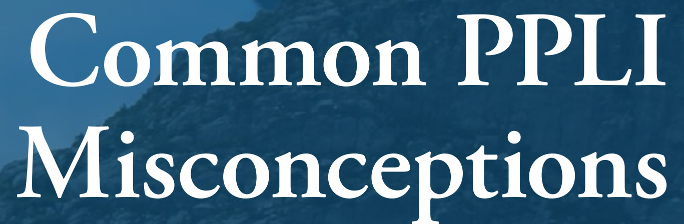

Common PPLI Misconceptions

By Ben Rainey and Aidan Elliott

"In the choice between changing one's mind and proving there's no need to do so, most people get busy on the proof."

-John Kenneth Galbraith

It is of little surprise that something as complex as PPLI would be misunderstood. In our conversations with clients and advisors across the country, misconceptions surrounding the strategy surface time and time again. Most of our misconceptions are rooted in our prior experiences or our limited understanding of a topic. Similarly, most ultra-affluent clients and advisors have either a limited understanding of or limited prior experience with PPLI. The following is intended to dispel some common misconceptions around PPLI.

"It is hard to use the money in the PPLI account."

Traditional insurance is most people's prior experience with life insurance and this statement is accurate for traditional, retail products. The same is not so for PPLI. In fact, accessing the money in a PPLI policy is easy. The owner has access to 85% to 95% of the liquid positions of the account within a few days' notice through policy withdrawals and loans.

"The money in PPLI should be considered 'last resort' money."

Not only is accessing the money in PPLI easy, but we also often teach, coach and cajole our clients to instead consider this PPLI account as potential "first resort" money.

What better place to find the liquidity you need than from a tax-free account? Moreover, that same tax-free account can be replenished later by repaying the loan taken against it. We like to tell our clients that they should view their PPLI account as a two-way Roth IRA with none of the income or age limitations.

"It is an irrevocable decision."

If anything, PPLI is one of the most flexible strategies our clients will ever implement. Unlike traditional life insurance policies, there are no surrender charges, huge up-front fees or commissions paid in PPLI. If you implement a PPLI account and change your mind, the cost of unwinding the transaction is minimal. In many of our designs the cost of implementing a PPLI account is less than the cost of taxes from year one forward. As a result, even if the client decided they wanted out of the strategy after only one year, they would still be better off having implemented PPLI.

Additionally, as discussed above, premiums paid into the account are easily accessible, and both the owner and beneficiary can be changed at any time (subject to normal gifting limitations).

"My clients are fully invested and they will incur too much tax for it to work."

PPLI is a great idea for those with large liquidity events, but for clients who are fully invested it still makes sense to implement. WealthPoint has built a modeling tool to address this concern and misconception specifically.

Most investors do not have eight or nine-figure positions with a near zero basis. Instead, they have large portfolios and the basis to match. We have found that the cost of liquidating the positions required to fund PPLI is de minimis over time.

For those with an aversion to paying any taxes to implement, we have a solution. One simple and creative way around liquidating positions and paying tax today to fund PPLI is using a securities-based line of credit (SBL) to pay the required cash premiums. The SBL can often be repaid quickly with normal portfolio rebalancing, turnover and tax-loss harvesting.

"Insurance is really expensive at older ages."

This statement is 100% true for traditional life insurance. However, if PPLI is properly structured and managed, the costs will not become an issue no matter how old the client.

In every insurance contract there is a cost of insurance (COI) charge. For permanent life insurance contracts, including PPLI, this charge is assessed on the Net Amount at Risk (NAR). The NAR is the difference between the account value and the total death benefit.

PPLI is designed so that after a few years the death benefit is dropped to reduce the insurance costs. The remaining NAR is quite low. As a result, PPLI is often on the order of 60% to 70% cheaper than paying taxes.

Yes, insurance is technically more expensive at older ages but it is not an inhibitor to the overall value created by implementing it.

Summary

Like many strategies in the marketplace, PPLI is often misunderstood. We empathize with Mr. Galbraith's above remark. Many of us are not comfortable with changing our minds once we have made a decision. It is paramount that we get clear on the facts as often as possible. There are real reasons not to implement PPLI, but being encumbered by one of the above misconceptions should not be one of them.

"Like many strategies in the marketplace, PPLI is often misunderstood."

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The Downsides of PPLI

By Ben Rainey and Aidan Elliott

"The wise general in his deliberations must consider both favorable and unfavorable factors. He ponders the dangers inherent in the advantages, and the advantages inherent in the dangers."

-Sun Tzu

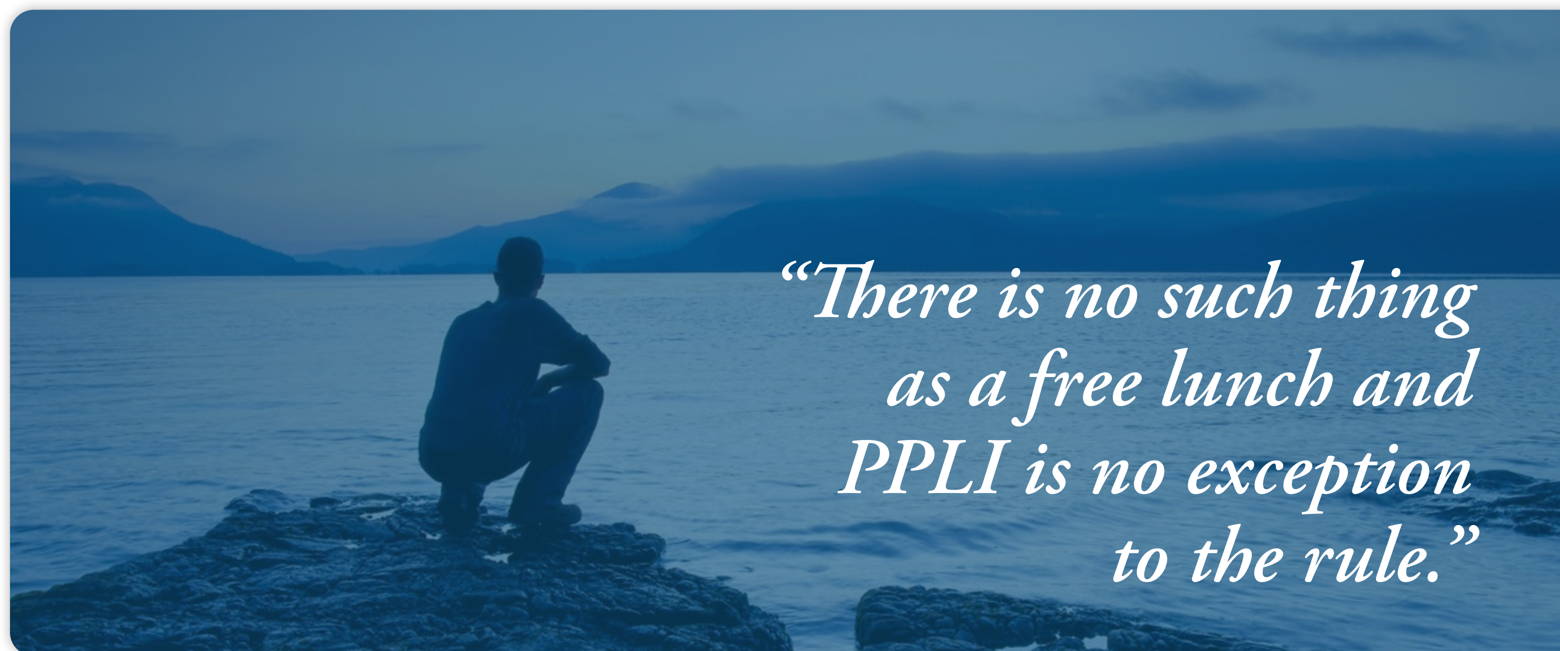
"So what's the catch?" We hear this from both clients and advisors alike when discussing the benefits of PPLI. Most affluent investors are used to proposals that conveniently overlook, or worse yet, intentionally hide the less attractive components of the strategy being proposed. We take the opposite approach when discussing PPLI. We not only bring up the downsides, but also thoroughly discuss where it might break or go awry (see also chapter nine - "Where it Breaks").

There is no such thing as a free lunch and PPLI is no exception to the rule. There are legitimate downsides to implementing PPLI, and investors and their advisors should be keenly aware of them.

Investor Control

This is the number one reason clients choose to not implement PPLI. The "investor control" doctrine (ICD) states that the policyowner may not have any direct control over the investment positions within the PPLI contract. This means they cannot call their investment manager and have input on any specific investments. For many investors, this is a non-starter.

While it is true the owner can be involved in drafting the investment policy statement (IPS), making it specific or generic, and modifying the directive as often as he or she wants, the reality is that for many investors they are unable to fully "let go." Their accounts are discretionary in name only.



So, when the investment manager wants to deploy capital in a promising private equity deal, credit strategy or hedge fund, he or she cannot get permission from the investor prior to making that decision. This makes many investors uneasy and if that applies, you are not a good candidate for PPLI.

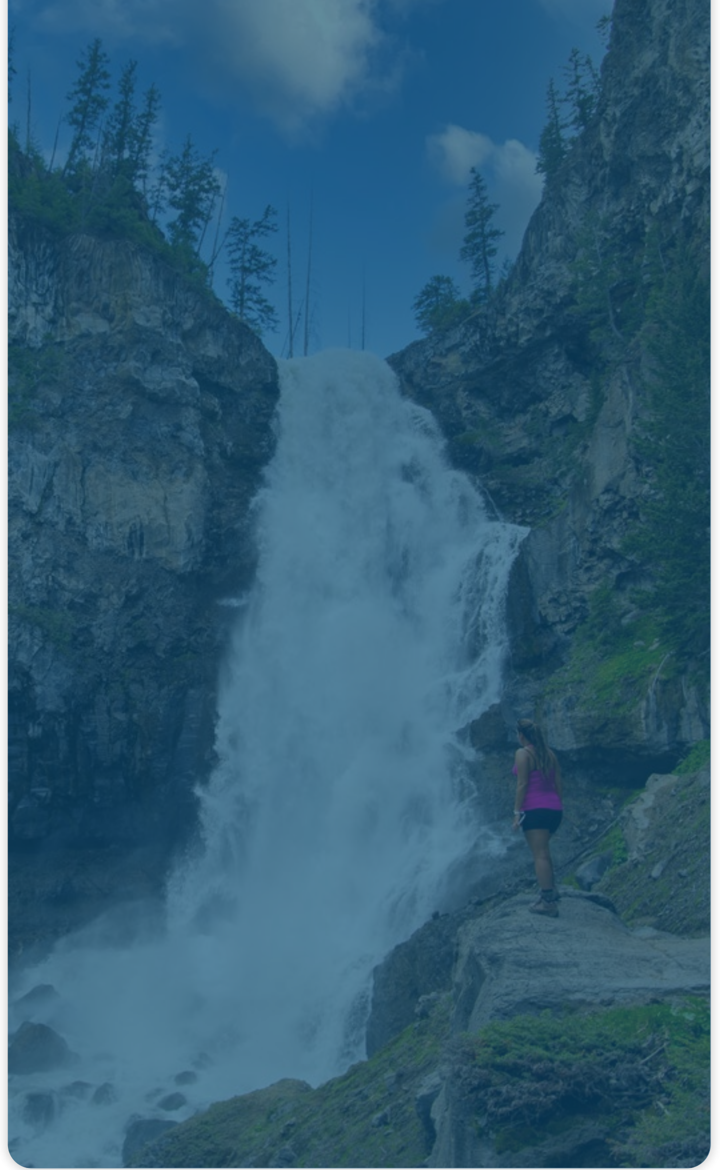
The only time PPLI has ever been successfully challenged in tax court was due to a breach of the ICD. The case is well known – Webber v. Commissioner (144 T.C. No. 17 (2015)) – and involves the investor sending thousands of emails to his investment advisor with specific investment directives which were subsequently followed.

Cash Premium Payments

This is another dealbreaker for a lot of clients. You cannot transfer assets "in-kind" as premium payments. Although there are promoters (primarily offshore) who say that you can do this, they are wrong. It is a clear violation of the investor control doctrine mentioned above.

Liquidating positions and paying tax today will often cause investors to halt on moving forward with PPLI. We have come across numerous individuals with nine-figure positions in publicly traded companies with a near zero cost basis. For these individuals, the thought of selling the positions and paying the tax is too painful – we do not blame them. It is still probably better paying the tax today and enjoying a lifetime of future tax-free growth, but we all know that immediate pain is often too hard to overcome.

As we explored more thoroughly in chapter 7 – "Common PPLI Misconceptions", a good option for a client who is fully invested and averse to incurring unnecessary tax today is to fund the PPLI account with a securities-based line of credit. The credit line can then be paid down throughout the year as the investment professional does their usual tax-loss harvesting, rebalancing and tactical asset allocation changes.



Additional Complexity

The reality is that all high-net-worth clients have complex financial situations. That said, there are many individuals who still long for simplicity. PPLI will invariably add complexity no matter how simple we try to make it and it comes in the following forms:

- *PPLI will add at least one new account on the balance sheet and potentially more depending on your investment professional.*
- *It will require additional reporting from the investment manager and often complex tax calculations to show the true value of the tax-free return.*
- *Most clients will own PPLI in a jurisdictionally specific trust or LLC which will likely require a corporate trustee and registered agent.*

Summary

Millennia ago, Sun Tzu believed that weighing the pros and cons of a decision was a simple but effective strategy that allows for looking at a situation from different angles, considering appropriate solutions and making a confident choice. Nothing has changed since then.

PPLI is a terrific and proven concept, but as with anything there are downsides. We believe the rewards for the right individual or family group can be tremendous and worth the tradeoffs, but investors should approach anything like this with their eyes wide open.

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PPLI – Where It Breaks

By Ben Rainey and Aidan Elliott

"The old adage, 'If it sounds too good to be true, it probably is' isn't always correct. In fact, the suspicion, cynicism, and doubt that are inherent in this belief can and does keep people from taking advantage of excellent opportunities."

-Richard Carlson

When we first meet with our clients, most of them feel that PPLI seems "too good to be true." This is largely due to the economics in favor of the strategy. They are flummoxed when they see the value of investing in a new PPLI account instead of the status quo – staying invested in their taxable accounts. This disbelief then leads to a "what's the catch" mentality which usually takes our conversation to how PPLI can go awry or "break." When we use the word "break", we mean that the PPLI structure could fail and the client may suffer adverse tax consequences.

In short, there are only two scenarios that can break PPLI:

1. *The client violates the "investor control" doctrine (ICD)*
2. *The investment account underlying the PPLI contract does not meet the diversification requirements under section 817(h) of the Internal Revenue Code*

Investor Control

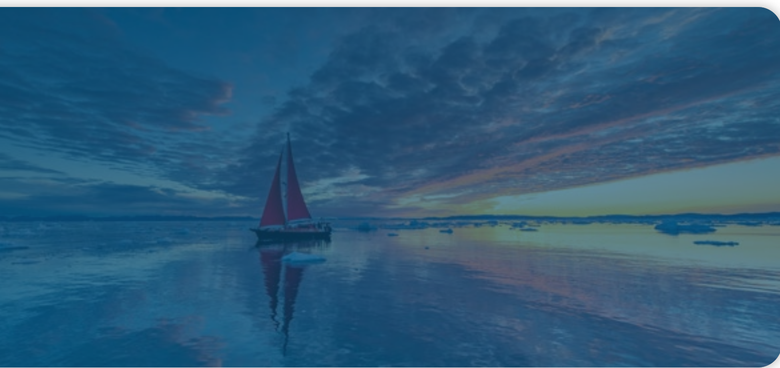
Several requirements must be met for a PPLI policy to be respected as life insurance under U.S. federal tax law. Among these is the requirement that the assets in the segregated investment account within the policy must be owned by the insurer and not the policyowner. To achieve this, the policyowner must relinquish significant control over the investment decisions regarding the policy investment account assets. This premise is often referred to as the "investor control" doctrine (ICD).

The simplest way to avoid issues with "investor control" is to restrict the policyowner from directing specific trades or investments. They cannot call up their investment professional and say, "buy Apple and sell Tesla." The investment professional also cannot buy anything that the policyowner might have ownership in already – think shares in a real estate fund or hedge fund that their client might be running.

So, what *can* the policyowner do and what influence do they have over the PPLI account? First, and most commonly, the policyowner may hire and fire the investment manager. This is partly why PPLI is seeing a significant resurgence in recent years. The ability for the ultra-affluent client to have their investment professional manage money in a tax-free location is quite appealing. This investment professional must be approved by the insurance carrier, and they should make all relevant day-to-day investment decisions in the PPLI account.

Second, the policyowner may also be involved in crafting an investment policy statement (IPS). This IPS may be as general or specific as the owner would like and they can amend it from time to time as they see fit, or as their goals and needs change.

Since the late 1970s, the Internal Revenue Service has issued a series of published revenue rulings and private letter rulings to better define the parameters of the ICD and to date, there has only been one case where the tax court concluded a client was in breach of it. In Webber v. Commissioner (144 T.C. No. 17 (2015)), previously referenced in chapter 8 – "The Downsides of PPLI", the IRS discovered that the policyowner had exchanged over 70,000 emails to his planning team instructing them to buy and sell certain securities. His investment advisor acted on these instructions and the IRS was successful in challenging the PPLI policy. As a result, the IRS collapsed the PPLI policy and all the investment gains that had accrued were taxed.



817(h) – The Diversification Requirements of the Investment Portfolio

In 1984, Congress enacted the diversification requirement of Section 817(h) with the intention to "discourage the use of tax-preferred variable annuity and variable life insurance primarily as investment vehicles." This general diversification test is easily satisfied provided that (i) no more than 55% of the value of the total assets of the account is represented by any one investment; (ii) no more than 70% of the value of the total assets of the account is represented by any two investments; (iii) no more than 80% of the value of the total assets of the account is represented by any three investments; and (iv) no more than 90% of the value of the total assets of the account is represented by any four investments. There is another safe harbor test and alternative test for diversification, but a description of these is beyond the scope of this piece (for additional detail, visit https://www.irs.gov/pub/irs-drop/n-16-32.pdf).

It is important to note that the PPLI policyowner is not penalized for investment performance with regards to 817(h). The growth of the underlying investment account cannot cause failure of the diversification test. For example, were you to buy pre-IPO shares of a tech company and then have that tech company go public, the subsequent growth in value of those shares will not trigger an 817(h) violation.

Summary

Harkening back to Richard Carlson, the bottom line is clear. When things seem too good to be true it can unduly influence our decision making. However, when we combat this initial urge and gain a deeper understanding of the facts and potential pitfalls, we achieve greater clarity and can in turn make better decisions not only with our wealth but in life too.

If we can begin our conversations with what can go wrong – where things "break" – it might help us with our human propensity for cynicism and doubt that can prevent us from capitalizing on opportunities that can positively impact our balance sheet. Provided we abide by the two simple rules referenced above, PPLI does not break and in fact is not too good to be true.

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PPLI and Perceived Regulatory Risk

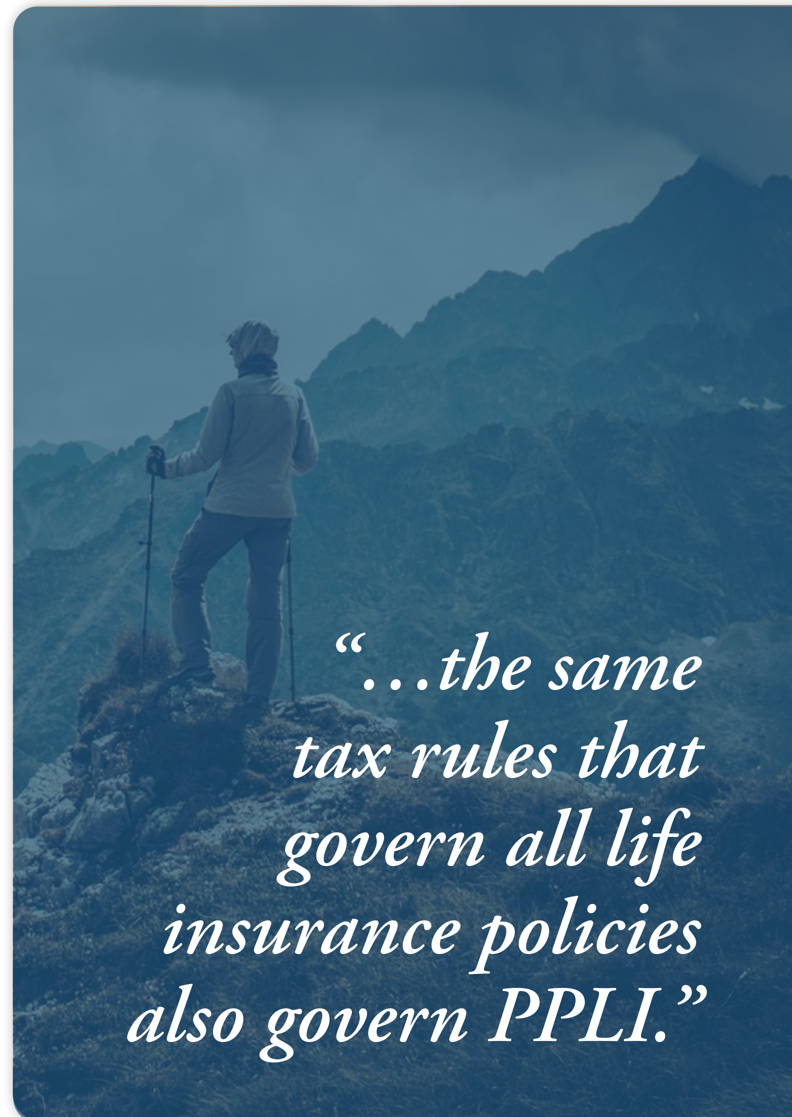
By Ben Rainey and Aidan Elliott

"It would be foolish, in forming our expectations, to attach great weight to matters which are very uncertain."

-John Maynard Keynes

When our clients first learn about PPLI and the tremendous advantages it can create, they are often skeptical and worried about future regulatory risk. How can something so beneficial be legal? If it is legal, might congress or the IRS take it away? Or worse, by implementing PPLI do I create a target on my back for the IRS down the road?

We hear these concerns often and we are sympathetic to them. Nobody wants to spend time and money implementing something that is going to be taken away in a couple of years. Nor do they want to create additional IRS sctrutiny down the road. We are hopeful that this chapter will be cathartic to those worrying about any future regulatory risk that may impact PPLI. In short, we are not worried and below are the reasons why.



The Tax Code and History are in our Favor

The most significant protection PPLI is afforded comes in the form of the tax code. In the code, PPLI is simply a variable universal life (VUL) insurance policy. Therefore, the same tax rules that govern all life insurance policies (including VUL) also govern PPLI. What makes PPLI unique is not the structure, but the vast array of investments that qualified purchasers can access.

As a result, we believe it would be very difficult, if not impossible, to carve out PPLI and change its favorable tax treatment.

While Congress could attempt to change the code and eliminate the tax benefits of life insurance, PPLI would still likely be protected. All prior regulation changes affecting life insurance have resulted in the grandfathering of strategies put in place previously. The most recent example of this is the major tax acts of the 1980s, commonly referred to as TEFRA (1982), DEFRA (1984), and TAMRA (1988). If recent history is any guide, prudent planning put in place today should remain insulated from any future regulatory changes.

PPLI is not a Big Revenue Generator

We do not believe the PPLI market is large enough to be threatened or targeted. The PPLI market sits at roughly $100 billion in total assets. Provided the IRS or Congress were able to tax 100% of all the gains, that might result in only a few billion dollars in tax revenue. There is just not enough tax revenue to warrant the complete tax upheaval necessary to change any regulation surrounding life insurance. Contrast that with the nearly $40 trillion sitting dormant in qualified plans (IRAs, 401ks, etc.) waiting to be taxed.

Even in the Worst-Case Scenario we are Better off With PPLI

The worst-case scenario would involve Congress changing the regulations surrounding PPLI and forcing distributions from the policy (similar to what is being proposed with both traditional and Roth IRAs). However, as stated previously, PPLI is a life insurance policy – and that is a good thing.

If Congress were to pass a retroactive bill that would tax PPLI policies, we still have an “off-ramp.” In the U.S., cost basis and investment gains within a life insurance policy can be accessed tax-free via withdrawals or loans. Should legislation impacting PPLI become imminent, we could simply help our clients access 85% to 95% of all account values tax-free prior to any implementation. Those who implement PPLI would still benefit from the tax advantages until such a legislative change was made.

Summary

In short, there is nothing to do and no need to respond in anticipation of a perceived regulation change. Instead, be guided by John Maynard Keynes’s truism – do not attach weight to such an uncertain matter. Instead understand that PPLI is a tremendous wealth creation vehicle today and will remain so for the foreseeable future.

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Client Concerns Around PPLI

By Ben Rainey and Aidan Elliott

"You need comfort that the risks and exposures are understood, appropriately managed, and made more transparent for everyone...this is risk intelligence."

-Rick Funston

We received an email from a prospect recently out of the blue. We had not had a conversation with him yet, but we had been in discussions with his investment advisor. He had done his homework on PPLI and sent us a list of concerns prior to the meeting:

- *It looks like PPLI is expensive. Can you tell me exactly what I'm paying for?*
- *I am worried about additional administrative pain. Is there any and is it justified?*
- *My friend said there will be investment limitations associated with the underlying investment account. Can you explain these to me?*
- *What are the future regulatory risks that I should be thinking about?*

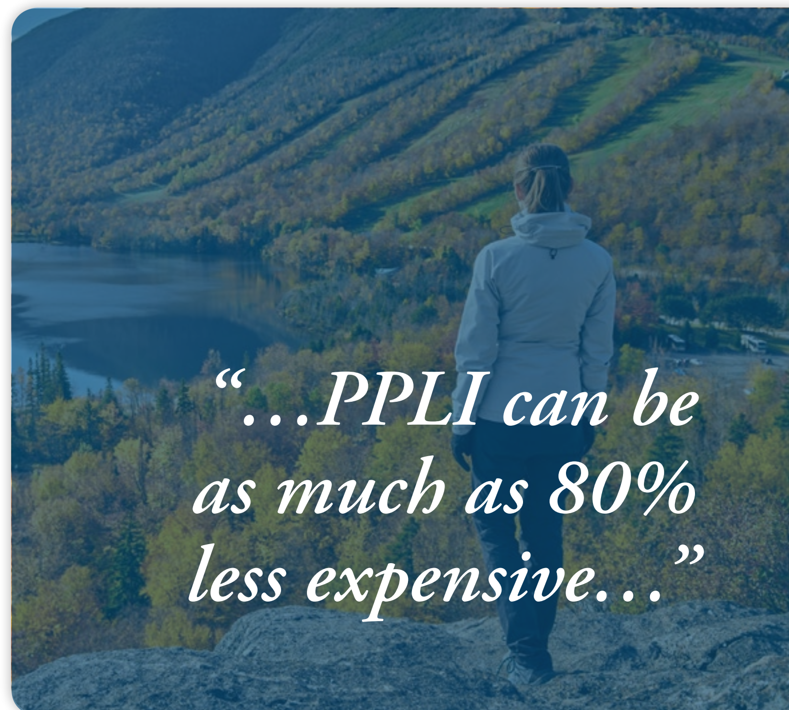
Our prospect had done his research and clearly articulated his questions giving us the opportunity to prepare and respond. The conversation went well, and we were able to assuage his initial reservations. As so few potential clients are as direct, but likely sharing similar concerns, we will briefly share our responses here.

Is it expensive? What am I paying for?

As with anything, context is everything. Nearly every PPLI policy will incur millions of dollars in costs and expenses. The question is not whether PPLI is expensive. It clearly is. The question is, what does one get in return for the associated expense?

PPLI is all about trading the cost of taxes – the status quo – for the cost of insurance. What is the cost of taxes? Most clients have no idea because no one has had the need or desire to quantify a problem that heretofore could not be solved. Consequently, we built a modeling tool to help our clients see exactly how much they are paying in taxes, not just this year, but projected over their lifetime.

While we know tax rates change and investment performance fluctuates, we have found that PPLI, on average, costs less than half what one would otherwise pay in taxes over a lifetime. In some high-tax jurisdictions like California, PPLI can be as much as 80% less expensive than the cost of paying taxes. The bottom line is that PPLI is expensive, but consistently less expensive than the status quo.



Is there additional administrative pain I must endure?

Yes, but it is minimal for most individuals, and we work closely with a client's other professionals (tax, legal, investment, etc.) to do as much of it in the background so as to minimize the disruption.

A few examples of additional administrative hurdles that one must jump are as follows:

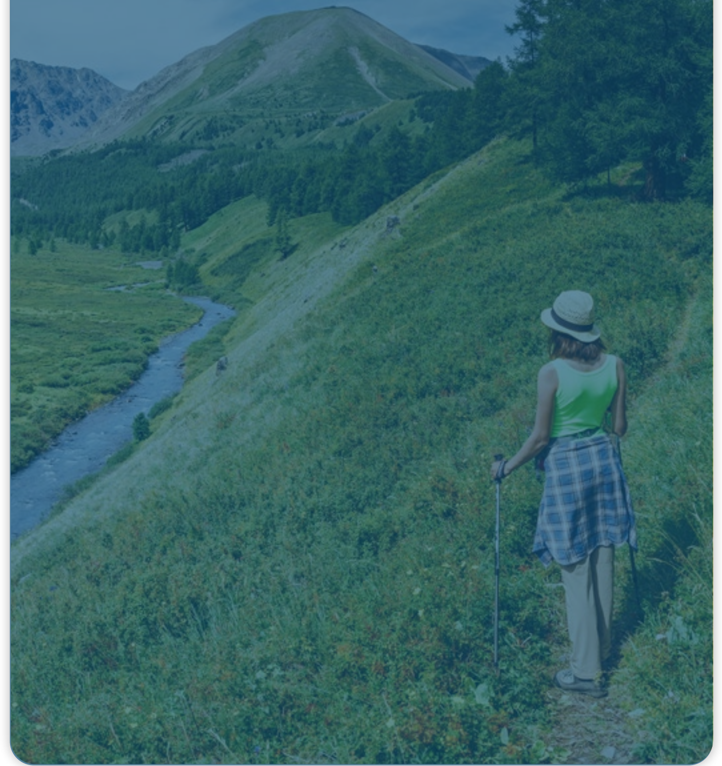
- *As with traditional life insurance policies, a formal medical and financial underwriting process is required.*
- *There is likely to be an additional LLC created to hold the PPLI policy due to significant premium tax savings offered by one of four states – Alaska, Wyoming, South Dakota and Delaware.*
- *There will be another investment account set up by the owner's investment professional so that they can manage the money that is inside the PPLI policy.*

Again, most of this additional administrative planning takes place in the background and early in the process. The long-term administrative headaches are minimal.

What are the future regulatory risks going forward?

Regulatory risk is unequivocally our clients' biggest concern. Any product or strategy that produces such outsized advantages usually carries commensurate risk.

In short, we do not believe there to be any significant regulatory risk surrounding PPLI. It is simply a variable universal life (VUL) insurance policy that allows for exotic investments for qualified purchasers. In the eyes of the Internal Revenue Code, there is no such thing as PPLI, it is all just VUL. It is the same as any other insurance policy that millions of Americans already own and buy every day. For a more thorough explanation, please be sure to review chapter 10 – "PPLI & Perceived Regulatory Risk".



What are the investment limitations associated with the underlying PPLI investment account?

In traditional retail variable life insurance, investment options are typically limited to a menu of pre-approved state registered mutual funds, often referred to in insurance parlance as VITs. This is not the case with PPLI. Thanks to the maturation of the PPLI marketplace, one's current investment professional can manage the underlying investment portfolio within the insurance contract by opening a separately managed account (SMA) with his or her current custodian.

The investment manager can then allocate the premium dollars to nearly any investment strategy available on their current custodian platform like Schwab, Fidelity or Ameritrade. The policyowner can now participate in investments like private credit, private equity, ETFs, managed futures, REITs and LP interests within these tax-favored vehicles just as they would in a taxable account. Certain insurance companies will limit the alternative asset exposure in the underlying portfolio to between 30% and 70% of the total account. The remaining percentage will need to be invested in T2 liquid investments (think stocks and bonds) or the company approved menu of IDFs or VITs.

To preserve the income tax-deferral of investment gains inside of PPLI, the investments must be diversified pursuant to Internal Revenue Code §817(h) and additionally satisfy the "investor control" doctrine (IDS). The IDS limits the amount of influence the policyowner can exert over the investment decisions, but they can be involved in creating and amending the Investment Policy Statement (IPS) of the SMA.

Summary

Rick Funston highlights the importance of risk intelligence and the comfort it can create. We believe it is our job to keep Rick in mind and use this risk intelligence to guide our clients through the malaise of hazards they face and highlight when they should be worried and when they should not. It is our hope that this has provided that comfort.

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Thoughtful Application of PPLI

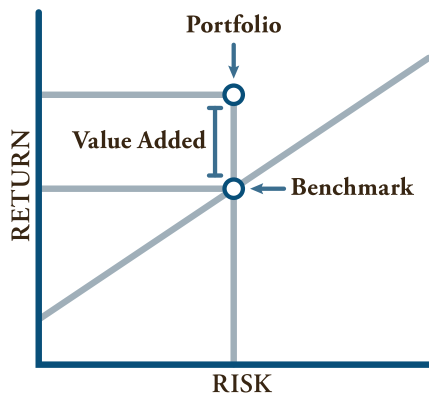
By Ben Rainey and Aidan Elliott

“man muss immer umkehren” or, loosely translated, “invert, always invert.”

-Carl Jacobi

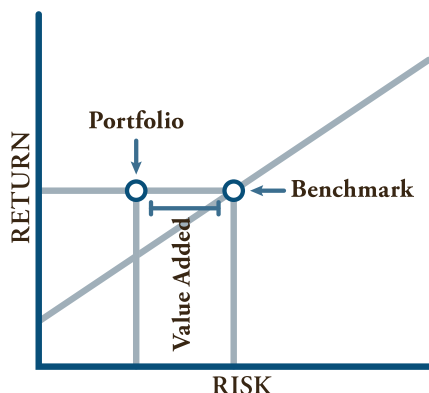
Howard Marks, the famed investor of Oaktree Capital has, unbeknownst to him, been a mentor of ours for several years now. We find his newsletters and podcasts incredibly useful and recently we reviewed his book "The Most Important Thing" for a second time. It is a provocative read and this time around it had us thinking about our niche in PPLI and how it is understood.

To Marks, outstanding investors are distinguished as much for their ability to control risk as they are for generating return. Some think that superior investing is demonstrated when a manager can take the same risk as a benchmark, the S&P for example, and earn a superior rate of return on their portfolio. The following graph presents this idea and depicts the manager's "alpha," or value added through skill.



This manager – "Manager A" – has done an amazing job and if able to keep up this achievement, will likely be a billionaire like Marks in no time.

However, Marks would view this as only half the story. The markets can also offer the ability to achieve the same return as the benchmark while taking less risk. To us and Marks alike, this is an even greater accomplishment, and it is reflected in the graph below.



The value added by this manager – "Manager B" – comes not through higher return at a given risk, but through reduced risk at a given return.

Relating This to PPLI – Creating Structural Alpha Through Beta

In most PPLI planning conversations, advisors quickly adopt Manager A's philosophy. They recommend putting your high returning, tax-inefficient investments inside PPLI. They discuss adding "structural alpha" to portfolios and augmenting the returns by trading insurance costs for taxes. This indeed is a fantastic use case for PPLI, and it is reflected in the example below:

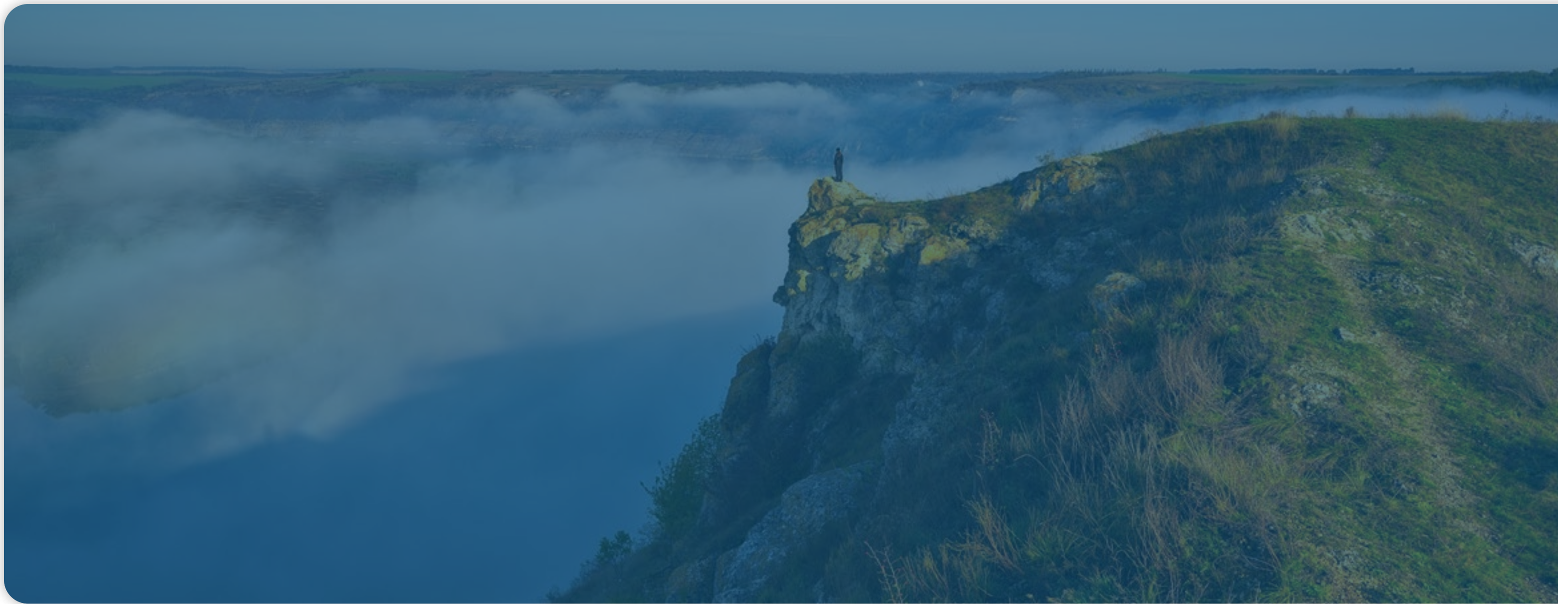
Same Risk - Higher Net Rate of Return		
	Traditional Investments	PPLI
Gross ROR/Risk of Investments	7.00%	7.00%
Less: Taxes & Fees	-2.45%	0.00%
Less: Insurance Charges	0.00%	-1.00%
Net ROR	4.55%	6.00%

"The other half of the story is that PPLI can be a tool to help reduce risk in portfolios."

This obviously makes a terrific case for utilizing PPLI, but it is only depicting half the story and half the utility of PPLI for investors.

The other half of the story is that PPLI can be a tool to help reduce risk in portfolios. Because insurance costs are less than taxes, investors keep more of what they earn. This allows investment managers to adopt a Manager B type of philosophy and achieve the same net return with statistically less risk. Therefore, they can adopt a more conservative investment allocation in their portfolios and still net the same as a taxable account that is more aggressively allocated. By eliminating income taxes, less risk can equal the same return. This is seen in the table below:

Less Risk - Same Net Rate of Return		
	Traditional Investments	PPLI
Gross ROR/Risk of Investments	7.00%	5.55%
Less: Taxes & Fees	-2.45%	0.00%
Less: Insurance Charges	0.00%	-1.00%
Net ROR	4.55%	4.55%



Summary

It is not enough to think about difficult problems from only one viewpoint, and it is no different when planning with PPLI. We should instead strive to be a little more like Carl Jacobi when it comes to increasing our understanding. Inverting our initial understanding often enables us to realize embedded and preconceived realities that have hampered our ability to problem solve and create greater outcomes for ourselves and our clients.

Relating this to PPLI, the choice between offense and defense is a subjective one and either can lead to success. Utilizing PPLI in a portfolio can be return enhancing, risk reducing or a combination of both. It can create the Manager A and Manager B situation organically and simultaneously. Howard Marks would likely favor the risk reduction option. Perhaps we should be thinking about implementing it more in our planning with PPLI too.

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By Ben Rainey and Aidan Elliott

What is Private Placement Life Insurance (PPLI) and Private Placement Variable Annuity (PPVA)?

PPLI and PPVA are comprehensive wealth management tools offered by domestic and foreign insurance companies that allow clients to invest on a tax-advantaged basis in certain investments through variable insurance products. When properly structured, they allow ultra-high-net-worth investors, as well as some institutional investors, to defer and/or eliminate taxes on the growth of investments held within the policy, as well as shield those assets from unwanted predators.

Clients have the ability to invest in tax-efficient asset classes with potential to compound their wealth much more effectively over the long term than they can by investing on a traditional "taxable" basis. When structured properly within an overall estate plan, PPLI also allows individuals to transfer wealth to future generations in a tax-effective (income tax, estate tax and GST tax-free) manner.

PPLI & PPVA products tend to carry much lower overall upfront and ongoing costs when compared to retail or traditional insurance products, as well as provide access to a wider range of potential investments through the contract (including hedge funds, private equity, private credit, real estate, and other real assets).

How does it work?

In exchange for one or more premium payments from the client, an insurance carrier issues a PPLI (life insurance version) or PPVA (variable annuity version) insurance contract. The policy's terms and amount of death benefit (if a PPLI contract) are negotiated upfront with the insurance company.

The assets used to fund the policy by the client are placed by the carrier into a separate investment account linked to the contract, also known as the policy's "cash value." In the case of PPLI, the contract also provides a corridor death benefit in excess of the policy's cash value.

The cash value investment account assets are considered segregated from the general assets and liabilities of the insurance carrier. This cash value is then used to fund one or more investment options selected by the policyholder's investment advisor.

What are the tax attributes of PPLI and PPVA?

Invested cash value accounts grow tax-deferred within the PPLI or PPVA policy. Depending on the policy design, PPLI policyholders have the ability to access liquidity from the contract by borrowing tax-free from the policy's cash values during the insured's lifetime, so long as the policy is structured as a "non-MEC" contract.

If the PPLI or PPVA policy is surrendered prior to the policyholder's death, profits built up inside of the contract are taxed as ordinary income, while basis is returned tax-free. However, if a PPVA policyholder surrenders the contract before the insured reaches age 59 1⁄2, a 10% penalty will be applied.

Upon the insured's death, the contract's cash value and any additional death benefit (if a PPLI contract) are paid to the policy's beneficiary(ies) income tax-free (and potentially estate, gift and generation skipping tax-free if owned properly).

In addition to the above-mentioned benefits for high-net-worth investors, PPLI and PPVA policies (or rather, institutional versions of these products) can act as an unrelated business taxable income (UBTI) blocker for tax exempt investors, as well as a blocker for effectively connected income (ECI), the Foreign Investment Real Property Act of 1980 (FIRPTA) and branch profits tax (BPT) purposes for certain offshore individuals and institutions.

What investment strategies are typically held within a PPLI or PPVA policy?

Due to the tax-deferral benefits afforded PPLI and PPVA, many investors elect to hold tax-inefficient strategies (e.g., mutual fund, hedge fund, fund of funds, private equity, private credit, real estate, oil and gas and direct investments) or similarly, strategies that generate substantial capital gains, dividends or current income within the PPLI or PPVA chassis. By rule, PPLI and PPVA premiums can only be invested by the carrier via separately managed accounts (SMAs) or via insurance dedicated funds (IDFs). At present, there are approximately 180 different publicly available IDFs offered by various asset managers that have been approved on one or more of the major PPLI and PPVA insurance carrier platforms. An estimated two to three new IDFs are brought to market every month, mainly by way of existing hedge fund managers and RIA platforms. Some of the biggest managers in the IDF space include Golub Capital, Millennium Management and Ares Capital.

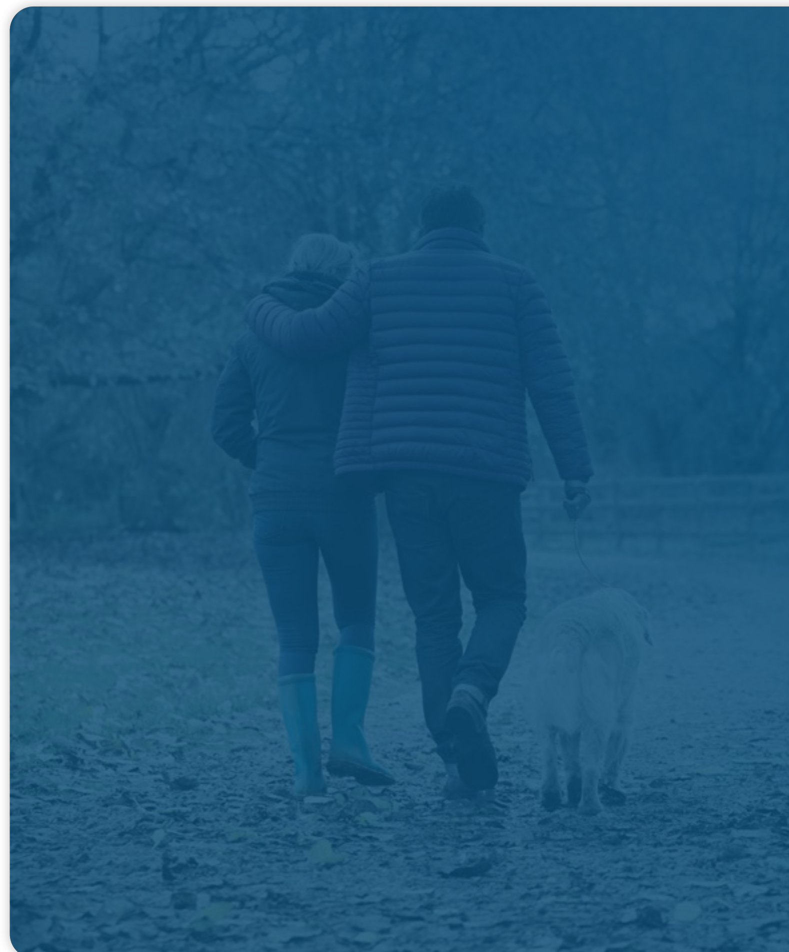
Who is an appropriate candidate to consider PPLI?

PPLI is only offered to accredited investors or qualified purchasers as defined by federal securities laws. To fully utilize the income, estate and asset protection planning features unique to PPLI, we recommend that clients considering funding a policy have a minimum net worth of $20,000,000 or more in investable assets.

How much should a client invest in a PPLI policy?

Given the relative complexity in structuring a new PPLI policy, as well as the pricing efficiencies that result from added scale, investors in PPLI should plan to fund a contract with $3,000,000 to $5,000,000 or more in premium payments. In certain instances, clients have funded these contracts with smaller amounts, however these situations are less common.

For most clients a good rule of thumb is that that the PPLI or PPVA should represent up to 20-30% of their overall investable assets.



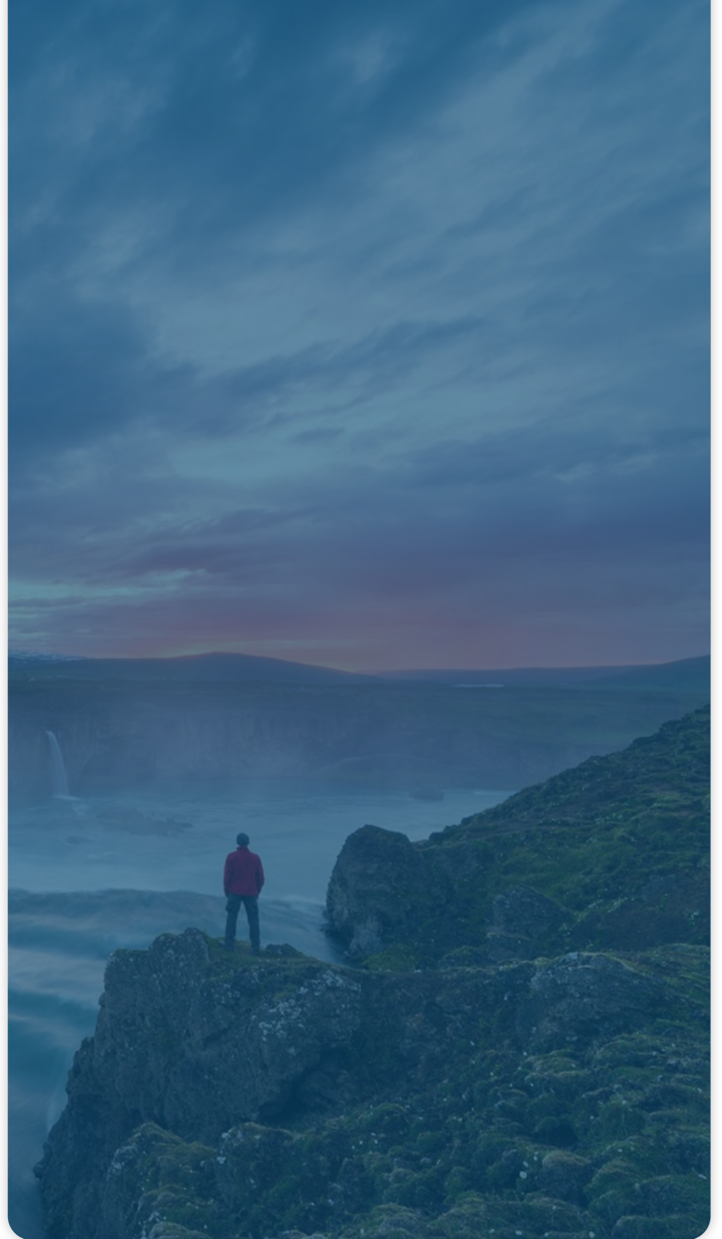
What are the asset protection attributes of PPLI?

PPLI and PPVA are considered asset-protected in 26 states, meaning cash surrender values are not accessible by potential creditors. Further, the use of certain onshore and offshore trusts and ownership structures to own the PPLI or PPVA can provide for additional asset protection benefits. Last, unlike most traditional insurance products, PPLI and PPVA policy cash values are carried in segregated accounts and are not subject to the credit risk of the insurance carrier.

What fees are associated with PPLI?

There are three primary levels of fees associated with PPLI products: 1) a one-time frontend premium load, 2) mortality and expense (M&E) charges and 3) the cost of insurance (COI) charges. The one-time premium load typically represents both a jurisdictional premium tax as well as a one-time "placement fee" charged by the agent who structures the contract. These fees are typically deducted from the policy after the client makes their premium payment(s) to the insurance company.

M&E charges represent an annual asset-based administration fee deducted from the policy by the insurance company



(defined as a percentage of the policy's cash value) and are paid to both the insurance carrier as well as the insurance agent who structures the contract, often referred to as the "policy trail".

Like the M&E fee, the insurance company will also deduct annual COI charges from the contract. COI charges will only apply to PPLI contracts, not PPVA. COI charges represent the cost of the policy's overall net amount at risk, or death benefit corridor. This is paid to the carrier (or as is often the case, to the reinsurance companies that help to underwrite the policy's death benefit). The amount of the COI charged by the carrier will depend upon such factors as the insured's age, relative health, and the amount of net amount at risk the PPLI carries.

How are PPLI and PPVA acquired?

In order to purchase a PPLI or PPVA policy, the prospective insured will typically be required to 1) submit a signed application to the carrier along with necessary Know Your Client (KYC) information (which could include color copy of passport, driver's license, home utility bill, reference letters from financial institutions, etc.), as well as 2) undergo full medical (in the case of PPLI) and financial underwriting.

As part of the PPLI medical underwriting process, the insured may be required to provide copies of prior medical records, submit to a physical exam and/or blood test, as well as complete a brief phone interview.

In addition, a properly licensed insurance agent is typically needed to sign the application. The agent will also help to coordinate the above-mentioned application and underwriting processes between the insured as well as the selected insurance carrier.

Who are the primary insurance carriers that offer PPLI?

There are a number of onshore as well as offshore carriers that write PPLI policies. In the US, Zurich North America, Lombard International Assurance, Prudential, John Hancock, Pacific Life, Crown Global and Investors Preferred Life are the most active carriers. Within the offshore marketplace, better-known carriers include Crown Global, Argus, Advantage Life, Ibex and Lombard International Assurance.

Depending on a client's investment thesis, careful consideration should be given to what carrier and jurisdiction the client selects to structure the policy. Different carriers display different levels of flexibility regarding the types of assets and investment strategies that can be acquired through the PPLI or PPVA contract. Certain carriers and jurisdictions will lend themselves better to clients who prefer that policy cash values are invested in certain illiquid, longer duration and other private assets.

What are some common ownership structures through which PPLI can be applied?

Many of PPLI's tax attributes can be properly leveraged through a variety of ownership structures. Selecting the proper ownership entity of the PPLI policy will depend upon a variety of tax and estate planning considerations unique to each client. A few examples of ownership entities that can help clients leverage the benefits of PPLI include, but are not limited to, an insurance trust, dynastic trust, charitable lead annuity trust (CLAT), family limited partnership (FLP), limited liability company (LLC), family limited liability corporation (FLLC) or charitable remainder trust (CRT). Further, owning PPLI and PPVA inside of certain trust structures can often help a client to "tax sanitize" or minimize the friction that tax costs can produce against a given asset or portfolio's overall return. PPLI and PPVA can also help alleviate the ongoing tax liability that settlors often face after contributing appreciating assets to grantor trusts.

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