

**One Man's Plan for His Legacy:
Use Life Insurance to Create Wealth**

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Mr. Smith, now 72 years old, grew up working in the automobile parts supply business started by his father. He accepted the reins of the family business and grew it significantly during the 1970's and 1980's. In 1993 he took the company public, but preserved family control by maintaining a majority share.

Like many patriarchs, Mr. Smith values control and legacy. These key values will resonate throughout this case study which explores how proper estate planning, together with a focus on preserving Mr. Smith's estate and legacy, transformed into a wealth enhancement story in a highly volatile economic environment.

Under Mr. Smith's leadership, the company thrived after going public, and by 2002 Mr. Smith's net worth exceeded \$500 million. Although other assets existed, most of the family's net worth was tied to the company. The company was prospering, and times were good for the family.

Flash forward to 2009: the current economic conditions have impacted the company's stock price significantly and Mr. Smith's net worth has plummeted below \$100 million, threatening one of Mr. Smith's core values—his family's legacy. However, Mr. Smith feels secure that his family's wealth will be restored and his ability to establish his legacy remains. Why? To paraphrase his words: "Because my wealth preservation strategy, based on estate planning, is now an effective wealth creation strategy."

Mr. Smith has more than \$160 million of insurance coverage on his life, coverage that was initially secured to eliminate the need to liquidate assets to pay estate tax liabilities upon his death. However, in the wake of the market downturn, the death benefit has a new purpose: it will replace a significant portion of Mr. Smith's wealth. Although this scenario was not discussed during the estate planning process, Mr. Smith now views his insurance portfolio in a completely different light: life insurance is an asset he can count on to create his legacy, even in the face of a declining net worth.

THE TEAM APPROACH

How did Mr. Smith end up with \$160 million of life insurance coverage? As with most estate planning processes, it took some time. In fact, as of 2002 when his net worth exceeded \$500 million, Mr. Smith had \$25 million of life insurance. One \$15 million policy was owned by a trust and another \$10 million policy was a corporate split-dollar plan. Both policies were purchased through one of Mr. Smith's fraternity brothers, a common occurrence when purchasing life insurance.

With Mr. Smith's net worth—and potential estate tax bill—growing at a rapid pace, the family's advisors, including an attorney and certified public accountant, stressed that serious estate planning should be a priority. These advisors also advocated the involvement of an experienced insurance advisor to provide expertise on plan design and product selection. It was important to select an insurance advisor using the same criteria used to select other family

advisors, focusing on traditional skill sets including reputation, demonstrated ability, and objectivity.

The advisor team reviewed various alternatives, implemented several estate freeze techniques, and then concluded that life insurance was the family's best option to preserve Mr. Smith's assets from estate tax erosion. One of Mr. Smith's sons was designated to spearhead the project and, together with the family's advisors, selected a specialty life insurance advisory firm to determine how best to purchase additional insurance coverage without incurring gift taxation. The selected firm is experienced not only in diverse product selection and policy implementation but also in situations like Mr. Smith's where prior estate planning techniques had exhausted gift tax exclusions.

In 2002, the insurance advisory firm began to work closely with the family attorney and accountant, becoming a key member of the family's advisor team. After discussing and modeling many alternatives, the family chose to have an existing Family Limited Partnership (FLP) acquire life insurance on Mr. Smith's life with cash inflows from various business ventures. Mr. Smith supplemented the FLP's inflows with private loans to provide sufficient premium funding and the insurance advisor successfully negotiated with three insurance carriers to effectively diversify risk across multiple carriers. The result: a net death benefit of \$18 million, 99% of which would be excluded from Mr. Smith's estate.

In addition, \$10 million of coverage was purchased on each of Mr. Smith's adult children. This coverage was diversified between two carriers and two product types—variable universal and current assumption universal life, an approach similar to asset allocation models used in investment portfolios.

In 2005, as Mr. Smith's net worth continued to grow, the family continued the estate planning process, asking their insurance advisor to review the coverage previously purchased from the fraternity brother. After a thorough assessment, the advisor concluded that the \$10 million corporate split-dollar plan was appropriately designed and performing well. However, the \$15 million policy owned by a 1983 trust was not performing at an acceptable level. This policy was, at that time, projected to lapse at Mr. Smith's age 91, and because Mr. Smith was in excellent health, he did not want to risk outliving his coverage. On behalf of Mr. Smith, the insurance advisor was able to negotiate with the current carrier to waive surrender charges on the existing policy and execute an internal exchange to a new policy with a higher death benefit guaranteed to age 125. No additional premiums were required.

By 2006, Mr. Smith's net worth had grown to \$700 million, but his total death benefit was approximately \$50 million. Driven by this imbalance, Mr. Smith determined that it was time to more fully fund his estate tax liability by using life insurance to preserve his family's wealth for future generations. An existing corporate entity was chosen to acquire additional life insurance on Mr. Smith, providing liquidity for a family buy-sell agreement, which again enabled the acquisition to avoid gift tax exposure. Over a period of five months, the insurance advisor led a negotiation process involving more than 20 major life insurance carriers and reinsurance companies to obtain the best possible pricing in the market. The result was \$120 million of death benefit, issued on best underwriting basis by six life insurance carriers, guaranteeing coverage on Mr. Smith's life to age 120.

The process: four years. The result: a total net death benefit of \$160 million. At the peak of Mr. Smith's net worth of approximately \$700 million in 2006, the insurance coverage

and other estate planning techniques positioned Mr. Smith to fully fund the estate tax and preserve his net worth for his children. With efficiency, teamwork, and focus, both of Mr. Smith's goals—passing on a legacy to his family while maintaining control during his lifetime—were met.

THE IMPORTANCE OF FLEXIBILITY

In 2008 the financial crisis took its toll on the company's value and Mr. Smith's net worth. The company's stock price was in free-fall during most of the fourth quarter, and Mr. Smith's net worth plummeted to \$100 million at year-end. Despite the declining stock price, the business remains successful and produces positive cash flow for the family. During the last 12 months, Mr. Smith could have reduced cash outflow by reducing his life insurance coverage. The design of his plan always allowed for adjustments in the face of changing objectives or circumstances.

However, he decisively chose the opposite approach: stay the course to protect and maintain his current coverage. Mr. Smith was the first person to recognize that his life insurance coverage had been transformed from an estate preservation plan to a wealth creation device. The protection provided by his life insurance portfolio is allowing him to preserve his ability to leave a lasting legacy and focus on the business he loves—something all entrepreneurs enjoy. He has also encouraged his children to implement estate plans utilizing life insurance. As a result, the insurance advisor is currently working with the third and fourth generations of the Smith family to formulate a comprehensive estate plan that will pass along the family's legacy for future generations.

Life insurance plays an important role in the estate planning of many affluent families. It is clear that the initial emphasis should be on the estate planning process. By implementing a sound, flexible estate plan, Mr. Smith retained an invaluable sense of comfort, especially in a turbulent market cycle.

In addition to seeing that life insurance is a unique asset that can play a valuable role in a complex estate plan, the Smith family also saw the value of the team approach. With legal, accounting, and insurance experts focused on effective, efficient, and flexible solutions, Mr. Smith was able to achieve his objectives: provide a family legacy and continue to run his business.