

The NAEPC Foundation 46<sup>th</sup> Annual Conference  
**Estate Strategies Group-New York**  
**Northwestern Mutual Financial Network**

Leveraging Wealth Transfer Strategies  
With Life Insurance

How Premium Financing Can Enhance Flexibility  
And The Outcome

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# Life Insurance: An Important Asset

# The Use of Life Insurance to Transfer Wealth

- Cash to pay a premium  
vs. Other opportunities
- Evaluating the results during  
life and at death

# Permanent Life Insurance Provides Asset Diversification

- Asset providing “Just In Time” liquidity
- Cash Value Growth Tax-Deferred Inside Policy
- Death Benefit - Generally Income Tax- Free
- Creditor Protection
- Long term results attained through payment of non-guaranteed dividends<sup>1</sup>
- Death Benefit can be Estate and GST Tax-Free
- Fixed-rate loans
- Un-correlated to other assets
- Importance of financial strength ratings

<sup>1</sup> The dividend scale and the underlying interest rates are reviewed annually and are subject to change. Future dividends are not guaranteed. The dividend scale interest rate should not be used as a measure of the policy's internal rate of return

# Sample Insured Family

- Husband & Wife – Both 45, Good Health; 3 Children
- Total Assets: \$23,000,000
- Current Estate Tax Liability: \$8,000,000
- \$8 M Survivorship Universal Life Insurance
  - Single premium of \$670,000<sup>1</sup>
  - Premium represents 2.9% of total assets

1. Premium based on non-guaranteed interest rates and best underwriting class. Policy is a modified endowment contract.

# Typical Investment Asset Classes

Rates of Return As Provided By Client

<b>Wealthy Family Portfolio</b>	<b>Pre-Tax Rate of Return</b>	<b>Rate of Return Net of Tax</b>
<b>Equities</b>	<b>8%</b>	<b>6%</b>
<b>Alternative Investments</b>	<b>15% ±</b>	<b>10%</b>
<b>Real Estate</b>	<b>9%</b>	<b>6%</b>
<b>Corporate Bonds</b>	<b>5 - 6%</b>	<b>3 - 4%</b>
<b>Muni Bonds</b>	<b>4%</b>	<b>4%</b>
<b>Cash Equivalents</b>	<b>2.5%</b>	<b>1.5%</b>

# Planning Through Your Rear View Mirror?

## Case Study

## \$42 Million Growing at Net of 4%

Year	His Age	Her Age	Estate Tax Liability
1	50	50	21,000,000
2	51	51	21,840,000
3	52	52	22,713,600
4	53	53	23,622,144
5	54	54	24,567,030
10	59	59	29,889,548
15	64	64	36,365,205
20	69	69	44,243,833
25	74	74	53,829,287
30	79	79	65,491,680
35	84	84	79,680,643
40	89	89	96,943,686
45	94	94	117,946,817
50	99	99	143,500,337

# Assumptions

- Couple – Age 50
- Annual Spending: \$350,000
- Growth In Annual Spending: 3% Annually
- Assets Growing At 4% Net of Tax
- \$320,000 Premium<sup>1</sup> For A Second-To-Die Life Insurance Policy

<sup>1</sup> Premium is based upon an illustrated Northwestern Mutual Survivorship Universal Life \$20,000,000 Second-to-Die Policy, Both insured's age 50, best underwriting class.

# Case Study

# Simple Estate Calculation

	(1)	(2)	(3)	(4)	(5)	(6)	
His Age	Her Age	Beginning Estate Value	Less \$350,000 Living Expenses (Indexed 3% for Inflation)	Add Net 4% Growth	Less Funds Given to ILIT for Premiums	Ending Estate Value	Estimated Transfer Taxes at 50%
50	50	42,000,000	(350,000)	1,666,000	(320,000)	42,996,000	21,498,000
54	54	46,160,860	(393,928)	1,830,677	(320,000)	47,277,609	23,638,805
59	59	52,077,796	(456,671)	2,064,845	(320,000)	53,365,970	26,682,985
69	69	66,771,182	(613,727)	2,646,298	(320,000)	68,483,753	34,241,877
74	74	75,841,775	(711,478)	3,005,212	(320,000)	77,815,509	38,907,755
79	79	86,294,221	(824,798)	3,418,777	(320,000)	88,568,200	44,284,100
89	89	112,200,504	(1,108,459)	4,443,682	(320,000)	115,215,726	57,607,863
99	99	146,526,349	(1,489,677)	5,801,467	(320,000)	150,518,139	75,259,070

# Case Study

# Insurance Policy

	(1)	(2)	(3)	(4)	
His Age	Her Age	Estimated Estate Tax at 50%	Death (*) Benefit	Annual Premium	Cash (*) Surrender Value
50	50	21,498,000	20,290,406	320,000	
54	54	23,638,805	21,638,488	320,000	1,330,919
59	59	26,682,985	23,834,592	320,000	3,636,869
69	69	34,241,877	30,783,754	320,000	10,783,754
74	74	38,907,755	36,138,112	320,000	16,138,112
89	89	57,607,863	58,786,728	320,000	38,786,728
99	99	75,259,070	67,055,897	320,000	47,055,897

\*Based upon Non-guaranteed illustrated values. These values and benefits include dividends used to purchase paid-up additions. Dividends assume no loans; loans may reduce dividends. Illustrated dividends reflect current (2009 scale) claim, expense, and investment experience and are not estimates or guarantees of future results. Dividends paid may be larger or smaller than those illustrated. These illustrated values do not recognize that, because of interest, a dollar in the future has less value than a dollar today.

# Background on Paying Premiums

- Client has the \$\$ but must deal with gift tax limits or desires flexibility

*or*

- Client does not have \$\$ and wants to avoid selling assets

# 3 Financing Methods

- Bank financing
- Private financing
- Private split dollar

# Financing Considerations

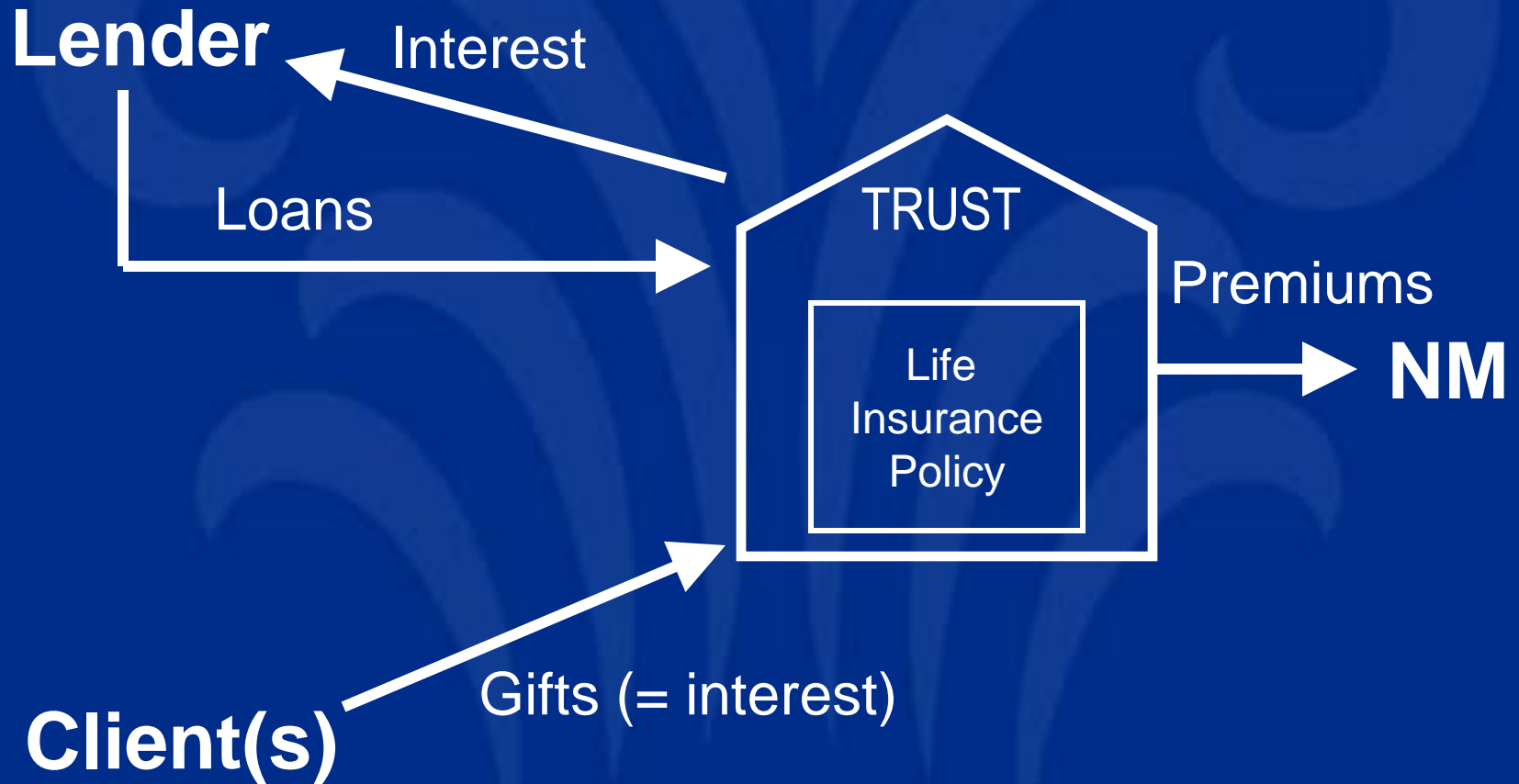
- Current Trends: Interest Rates, Estate Taxes
- Age, Duration of Arrangement, Risk Tolerance, Other Estate Planning Techniques In Place
- Planning Flexibility → Lend, Don't Give
- Exit Strategy

# Case Study: NM Survivorship UL

- Married Clients, both age 50
- \$20,000,000 life insurance need
- Goal: stop paying premiums in 10 years
- Illustrated annual premium = \$212,000<sup>1</sup>
- Lifetime gift exemptions exhausted
- Some annual exclusions available

1. Premium based on non-guaranteed interest rates and best underwriting class.

# Bank Financing: How It Works



# Bank Financing: Why Do It?

- Lower out of pocket cost
  - interest < premium
- Gift tax efficient
- Other people's \$\$
- Minimize the need to sell performing assets

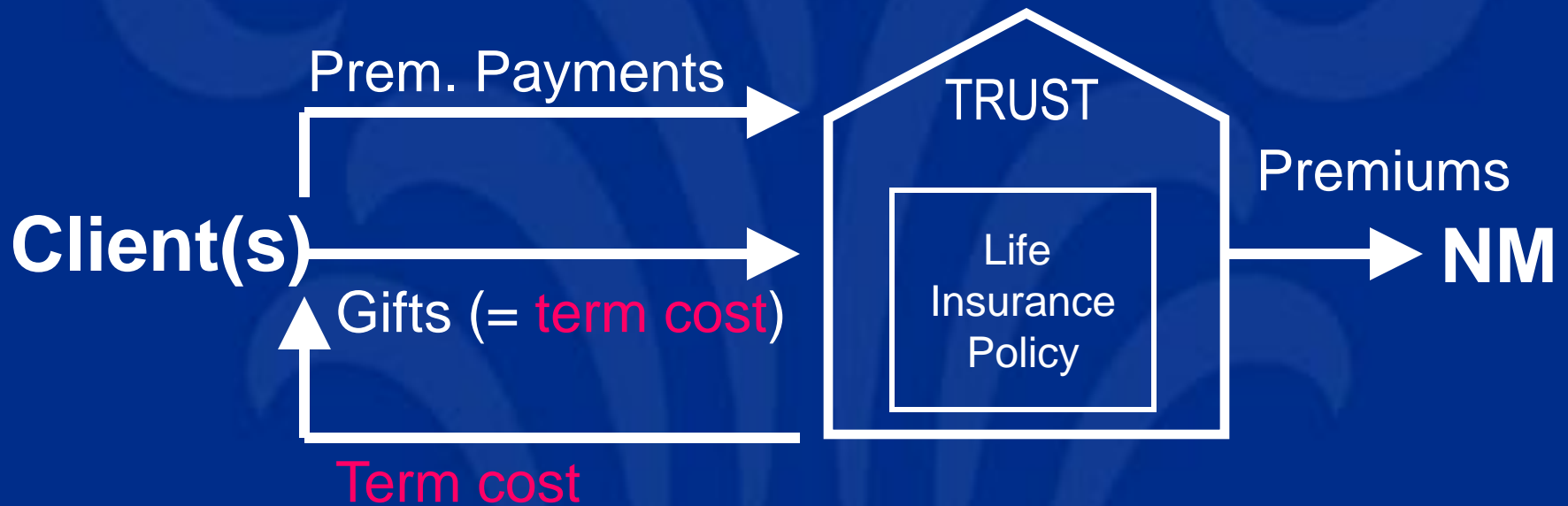
# Bank Financing: Risks & Drawbacks

- Does it Make Financial Sense?
- Interest Rates
- Bank might not lend future Premiums

# Private Financing: Why Do It?

- Lower Out of Pocket Cost
  - Interest < Premium
- Generally Lower Interest Rate Than Bank Loan
- Gift Tax Efficient
- Flexibility

# Private Split Dollar: How It Works



# Private Split Dollar: Why Do It?

- Term Cost < Premium
- Term Cost < Interest
- Gift Tax Efficient

# October 2009 Interest Rates

- GRATS (7520 rate) 3.20%
- Intra-Family Loans:
  - Less than 3 years: 0.75%
  - 3 to 9 years: 2.66%
  - Over 9 years: 4.10%

# Annual Gift Comparison

End of Yr.	Bank Financing*	Private Financing@	Priv. Split Dollar
1	\$ 15,900	\$ 8,692	\$ 109
2	\$ 31,800	\$ 17,834	\$ 132
3	\$ 47,700	\$ 26,076	\$ 164
4	\$ 63,600	\$ 34,768	\$ 212
5	\$ 79,500	\$ 43,460	\$ 277
6	\$ 95,400	\$ 52,152	\$ 357
7	\$111,300	\$ 60,844	\$ 452
8	\$127,200	\$ 69,536	\$ 559
9	\$143,100	\$ 78,228	\$ 661
10	\$159,000	\$ 86,920	\$ 757
<b>Total</b>	<b>\$874,500</b>	<b>\$478,060</b>	<b>\$3,680</b>

\* Assumed interest rate of 7.5%

@ Assumed interest rate of 4.10%

# Exit Strategies

- Early Death
- Cash Value
- Other Property:
  - Gift (forgiveness)
  - Sell assets
  - GRAT
  - Installment sale
  - Discounted gifts
  - Charitable Lead Trust

# The GRAT As An Exit Strategy

- Allows Client To Minimize or Reduce Gift
- Potential To Remove Appreciation From Estate
- Remaining GRAT Assets Pass To Life Insurance Trust, Which Trustee Can Use To Repay Client For Loans or Split Dollar Payments
- If Bank Financed Premiums, Trustee Liquidates Assets Before Repaying Bank Loans

# Maximizing GRAT Profits

# GRATs For Assets With High Growth Potential

- Scenario 1:

- \$1 Million of Securities In A Single 10-Year GRAT Earning An Average of 8%; At 7520 Rate of 5%,  
Remainder After 10 Years = \$282,000

- Scenario 2:

- \$500,000 into GRAT 1 earning 4% annually and \$500,000 into GRAT 2 earning 12% annually
- Remainder Values After 10 Years:
  - GRAT 1: \$0
  - GRAT 2: \$416,000
  - Total: \$416,000

Scenario 2 provides 48% more than Scenario 1

# 2-Year Rolling GRAT Analysis

\$10 Million Contribution: 10 Year Period from 1999-2008

Grat# (1)	Year (2)	S&P 500 Return (3)	7520 Rate (4)	GRAT Beginning (5)	GRAT Ending (6)	Remainder Values S&P 500 Returns (7)	Remainder Values- 6% Annual Returns (8)
	1999	21.0%	5.6%				
1	2000	-9.1%	7.4%	1999	2000	\$648,208	\$62,945
2	2001	-11.9%	6.8%	2000	2001	\$0	\$0
3	2002	-22.1%	5.4%	2001	2002	\$0	\$0
4	2003	28.7%	4.2%	2002	2003	\$0	\$71,283
5	2004	10.9%	4.2%	2003	2004	\$1,709,206	\$244,025
6	2005	4.9%	4.6%	2004	2005	\$362,253	\$245,203
7	2006	15.8%	5.4%	2005	2006	\$339,585	\$202,447
8	2007	5.5%	5.6%	2006	2007	\$616,612	\$89,992
9	2008	-37.0%		2007	2008	\$0	\$63,436
<b>Total</b>		-1.4%				\$3,675,865	\$979,330

(1) There are 9 – 2 Year GRAT's that could be created and completed from 1999-2008

(3) Actual return of the S&P 500 from 1999 through 2008

(4) Actual section 7520 rate from 1999 through 2008

(7) Based on columns (3) and (4) the remainder values are the amount passed from the GRAT free of gift tax. Assumes that the annuities from the GRAT each year are reinvested into a new 2-year GRAT. In years when the S&P 500 decreased and the GRAT failed, the amount contributed to the new 2-year GRAT is less than the expected value of the annuity.

(8) Based on column (4) and an assumed rate of 6.0% for each year from 1999-2008

# One Time Loan To An ILIT

# One Time Loan To A Trust To Fund Life Insurance

- Loan \$1,000,000 to trust today, lock-in low interest (long term AFR) rate
- Trust buys survivorship insurance
- Use Crummey gifts to 2 children to pay interest (\$35,800/yr at May '09 rates)
- Interest paid is not subject to income tax if the trust is a grantor trust

## Assets Remain In Estate

Beginning Age of (1)		Current Asset Value (2)	Plus Invest. Earnings at 6.0% (3)	Less Tax on Earnings at 40% (4)	Equals Net Value Before Estate Tax (5)	Less Estate Tax at 45% (6)	Net Value After Estate Tax (7)
39	36	1,000,000	60,000	(24,000)	1,036,000	(466,200)	569,800
58	55		117,486	(46,994)	2,028,594	(912,867)	1,115,727
68	65		167,334	(66,934)	2,889,300	(1,300,185)	1,589,115
78	75		238,332	(95,333)	4,115,193	(1,851,837)	2,263,356
<b>88</b>	<b>85</b>		<b>339,453</b>	<b>(135,781)</b>	<b>5,861,217</b>	<b>(2,637,547)</b>	<b>3,223,669</b>
98	95		483,478	(193,391)	8,348,055	(3,756,625)	4,591,430
103	100		577,000	(230,800)	9,962,862	(4,483,288)	5,479,574

## Proposed Arrangement

Beginning Age of (8)		Loan To Trust  One Time Premium (9)	Ins. Policy Proceeds (10)	Ins. Proceeds to Repay Loan Balance (11)	Excess Insurance Proceeds to Trust (12)	Added Value to Family After Estate Tax (13)
39	36	1,000,000	22,000,000	1,000,000	21,000,000	20,980,200
58	55		22,000,000	1,000,000	21,000,000	20,434,273
68	65		22,000,000	1,000,000	21,000,000	19,960,885
78	75		22,000,000	1,000,000	21,000,000	19,286,644
<b>88</b>	<b>85</b>		<b>22,000,000</b>	<b>1,000,000</b>	<b>21,000,000</b>	<b>18,326,331</b>
98	95		22,000,000	1,000,000	21,000,000	16,958,570
103	100		22,000,000	1,000,000	21,000,000	16,070,426

## Assets Remain in Estate

Year	Beginning Age Of		Current Asset Value	Plus Investment Earnings at 6.0%	Less Tax on Earnings at 40%	Equals Net Value Before Estate Tax	Less Estate Tax at 45%	Net Value After Estate Tax
	Carl	Jeanne						
1	62	60	1,000,000	60,000	(24,000)	1,036,000	(466,200)	569,800
10	71	69		82,488	(32,995)	1,424,287	(640,929)	783,358
20	81	79		117,486	(46,994)	2,028,594	(912,867)	1,115,727
30	91	89		167,334	(66,934)	2,889,300	(1,300,185)	1,589,115
40	101	99		238,332	(95,333)	4,115,193	(1,851,837)	2,263,356

## Proposed Arrangement

Year	Beginning Age of		Loan to Trust	Insurance Policy Proceeds	Insurance Proceeds to Repay Loan Balance	Excess Insurance Proceeds to Trust	Added Value to Family After Est. Tax
	Carl	Jeanne					
1	62	60	1,000,000	6,000,000	1,000,000	5,000,000	4,980,200
10	71	69		6,000,000	1,000,000	5,000,000	4,766,642
20	81	79		6,000,000	1,000,000	5,000,000	4,434,273
30	91	89		6,000,000	1,000,000	5,000,000	3,960,885
40	101	99		6,000,000	1,000,000	5,000,000	3,286,644

# Zero Estate Taxes: Leveraging Intra-Family Loans With Life Insurance

# Case Background

- Mom & Dad: age 50, 3 children
- Net Worth: \$50 Million; Liquid:\$40 Million
- Spending rate: less than \$1 Million / Year
- Already used both \$1 Million Exemptions; using Annual gifts for other purposes
- Some appetite for complexity to achieve objectives

# Objectives

- Pay \$0 estate tax
- Leave all assets at death to charity or family foundation
- Leave each child \$8 million
- Exempt from Generation Skip Tax

# Strategy

- Lend \$10 Million (cash or securities) to ILIT
- 9 year note @ 2.5% interest (mid-term AFR)
- ILIT invests the \$10 Million in 6% Corporate Bonds
- ILIT earns \$600,000 annually:
  - \$250,000 of interest is paid to the Grantor
  - Since ILIT is a grantor trust income tax on earnings is paid by the Grantor
- ILIT pays balance of \$350,000 annually into \$24 Million SUL policy for 9 years

# Results

- \$3,150,000 cumulative premiums (\$350,000 per year for 9 years) paid by trust income
- Before and after planning

	Before	After
Net Worth	\$50,000,000	\$50,000,000
Estate Tax Paid	\$25,000,000	\$0
To Charity	\$0	\$50,000,000
To Children	\$25,000,000	\$24,000,000
- GST Exempt?	No	Yes