WISCONSIN PLANNED GIVING COUNCIL

LIFE INSURANCE POLICIES:
THE MOST UNDER MANAGED ASSET CLASS

RESPONSIBILITIES AND OPPORTUNITIES
FOR NONPROFIT ORGANIZATIONS

OUTLINE

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I. INTRODUCTION

A. Background Information on the Different Types of Life Insurance

B. Techniques to Manage Existing Life Insurance Policies that Have Been Gifted to Nonprofits – Your Most Under Managed Asset Class

C. Two Life Insurance Gift Ideas

D. Income Tax Related Reference Information

II. TWO TYPES OF LIFE INSURANCE

A. "If I Die" - Term Insurance
- Limited Duration Universal Life Insurance

B. "When I Die" - Whole Life Insurance
- Lifetime-designed Universal Life Insurance

Assumptions:

1. We are assuming most of your life insurance gifts were intended to be continued until the insured's death to pay a death benefit to the nonprofit organization.

2. We are assuming that the nonprofit is the owner and beneficiary of the life insurance policies in your portfolio.

III. WHY DOES LIFE INSURANCE POLICY MANAGEMENT MATTER?

A. History of Interest Rates

1. Interest rates have been declining for many years. Interest rate crediting is the primary performance variable for many policies.

B. In-force Policy Performance

1. Many policies are under performing the original policy projection.

2. Under performing often means under funded. Under funded policies often make "When I Die" life insurance "If I Die" policies.

3. Will the insured outlive the policy? If so, the policy death benefit and cash value are zero. All premiums paid are lost, and there is no value to the nonprofit for this asset.

   This potential scenario is why this information matters.

IV. THREE KEY QUESTIONS IN YOUR LIFE INSURANCE POLICY MANAGEMENT

A. Are the "When I Die" policies in your portfolio performing adequately to pay a death benefit?

B. If not, what are the options available to preserve the value of the policy, to the extent possible, consistent with the donor's original and/or current wishes?

C. Will the insurance company be able to pay the death benefit when it becomes payable?

V. POLICY TYPES AND EXAMPLES

A. Term Life Insurance – "If I Die"

   1. When does the level premium guarantee period end? (See example page 3.)

   2. Is the policy convertible to more permanent insurance without medical evidence of insurability, and when does the guaranteed convertibility period end? (See example page 4.)

B. Low Premium Universal Life – "If I Die"

   1. When is the policy projected to lapse at current projections? (See example page 6.)

   2. When does the cash value start to decline? (See example pages 5 and 6.)

   3. Why does the cash value start to decline, and why will that decline accelerate? (See example page 7 – universal life annual statement.)

C. Guaranteed/Projected Universal Life (See example page 8.)

   1. The importance of **in-force illustrations**

      a. Only the servicing agent or the policy owner can request an in-force illustration.

b. "Based upon the current premiums, please provide an in-force illustration showing currently projected values every year until policy maturity or policy lapse."

2. Is the death benefit projected or guaranteed?

   Is the policy "If I Die" or "When I Die?"

D. Universal Life with No Lapse Guarantees – "When I Die"

1. How long does the guaranteed death benefit continue? (See example pages 9 and 10.)

2. Is the duration of the death benefit guarantee the same as the original policy purchase illustration or the most recent in-force illustrations?

   It is important to save all in-force illustrations for each policy chronologically. It is the only way you can determine accurately and quickly if policy performance is improving or declining. (See example pages 17 and 18).

E. Whole Life Insurance – "When I Die"

1. Is the policy entirely whole life insurance, or a blend of whole life and term insurance?

2. The projected policy dividends are not guaranteed and are usually correlated with interest rates. What are the policy dividends being used to do in the policy?

   a. Pay the premiums? Are the currently projected dividends sufficient to pay all future premiums, or are premiums projected to "reappear" in the future?

   b. If dividends are being stored in the policy, will they pay premiums in the future? (See example page 11.)

   c. If the policy is a combination of whole life and term insurance, are the dividends projected to be sufficient to cover future term insurance costs, or are premiums projected to increase in the future?

3. In-force illustrations will give you the answers to these questions.

F. Variable Life Insurance

1. The distinguishing characteristic of variable life insurance is that the policy offers a variety of stock and bond subaccounts for cash value investment within the policy.

2. Variable life insurance can be "If I Die" or "When I Die" depending on the level of funding and actual investment performance.

3. When requesting an in-force illustration, you must assume a gross annual investment rate of return. (See example page 12.)

G. Second-to-Die Life Insurance

1. This life insurance is also known as joint life insurance payable at the second death, or survivorship life insurance. Two people are insured and the death benefit is paid at the second insured's death. Most commonly, it is used to insure a husband and wife.

2. Second-to-die life insurance almost always costs less than insuring either person alone. As a result, it tends to be a very cost effective policy design for "When I Die" life insurance if the death benefit is not needed until the second insured's death.

H. Policy Loans and "When I Die" Policy Performance

1. Policy loans are a red flag for "When I Die" policies. Generally, loans against policy cash value will increase the policy costs because of policy loan interest charges, reduce the death benefit, and potentially lead to "When I Die" policies becoming "If I Die" policies.

2. If you have policies with loans against the cash value, we recommend the policies be reviewed very carefully to determine the long term impact of the policy loans, and possible strategies to reduce or eliminate the loans.

I. Ownership and Beneficiary Designations

1. Usually the owner and beneficiary of policies intended for charitable purposes are the nonprofit organization. If you have not verified the insurance company's records for ownership and beneficiary designations on policies in your portfolio, this verification should be done.

2. If a donor has named your nonprofit as beneficiary but retained ownership personally, you should be aware that the owner can change the beneficiary at any time.

J. Insurance Company Financial Ratings

1. We monitor life insurance company financial strength using the three major rating agencies that evaluate multiple industries: Standard & Poor's, Moody's, and Fitch. (See example page 13.)

2. We do not include A.M. Best because their agency rates only the life insurance industry.

VI. EXAMPLES

A. Whole Life Insurance

1. If policy dividends, as currently projected, are insufficient to pay all future premiums, an in-force illustration can show approximately how many premiums can be paid by the dividends, and how many premiums need to be paid by the donor. There may be some flexibility to accommodate the donor's cash flow and gift planning. (See example page 14.)

B. "When I Die" to "If I Die" and Back to "When I Die"

1. An under funded universal life insurance policy is projected to lapse at the insured's age 90. The insured is age 84 at the time of the in-force illustration. (See example page 15.)

2. A revised in-force illustration shows "the level annual premium required to project the policy beyond age 100." The insurance company calculated the level annual premium at $54,927. (See example page 16.)

3. The insurance company prepared a revised in-force illustration showing an annual premium of $30,000/year. (This is the premium the family had been paying until premium payments were stopped.) The projected duration of the policy is extended from age 90 to age 95. (See example page 17.)

4. Example page 18 is the same as in #3 except the in-force illustration was produced one year later. Note that the projected age 94 cash value decreased from $32,499 (example page 17) to $29,728 (example page 18). A small drop in projected cash value 10 years into the future indicates that projected policy performance has changed very little.

5. Another alternative to #3 above (example page 17) would be to drop the death benefit to extend the duration of the policy. (See example page 19.) Reducing the death benefit from $2,000,000 to $1,335,000 extends the projected death benefit duration from age 95 (example page 18) to age 102 (example page 19). However, there is also $665,000 less death benefit for the beneficiary.

C. Whole Life and Term Insurance Combined.

1. Decreasing policy dividends, due to low interest rates, made the dividends insufficient to pay for the term insurance costs. There were two policies and the total premium increased from $32,006 to $43,095.

2. The 75-year-old insured is in good health and it was possible to rewrite the life insurance to a different policy design with a $23,000/year premium that is guaranteed not to increase. (See example page 20.)

D. Conclusions

1. In-force illustrations are the cornerstone to managing "When I Die" life insurance.

2. Saving and comparing in-force illustrations will show policy trends and help you identify any potential policy problems.

3. If a policy is under funded, there are the options of paying more premiums, reducing the death benefit and, occasionally, rewriting the life insurance to a new, more efficient policy to correct the under funding.

4. The answers to the best solutions are dependent upon the donor's original intent, current wishes, and current health.

5. This donor information may not be readily available. However, these questions provide an opportunity to reconnect with donors and let them know that you are managing their gift thoughtfully and proactively.

VII. TWO GIFT IDEAS

A. Use life insurance to endow current annual gifts.

1.	Example	$155,000	(See example pages 21 and 22.)
		at 4%	
		$ 6,200	assumed annual gift to be endowed

In our example, slightly less than six years of gifts as a lump sum premium payment provide a guaranteed death benefit beyond age 100.

2. Each situation will depend upon the donor's age and health, as well as the policy design, duration of premium payments, and life insurance company selected. A possible guideline could be: 5-10 years of annual gifts paid into a life insurance policy up front may be able to endow the annual gifts at the donor's death. This guideline may be most applicable for donors ages 50-65.

B. Do the potential donors ages 55 and older in your donor database have any under managed life insurance policies?

1. Are their "When I Die" policies an "extra" forgotten asset? Could the policies be gifted without changing the donor's financial security? Would the donor benefit from an income tax deduction today by gifting a "forgotten" asset?

2. Life Insurance Policy Gifts – Tax Considerations

a. The gift of a life insurance policy is a non-cash gift and the income tax deduction is limited to the lesser of fair market value or the policy cost basis. (See example page 23.)

b. If the non-cash gift value is over $5,000, a qualified appraisal is required. Two resources for these appraisals are:

Bryan Clontz & Associates, LLC
bryan@charitablesolutionsllc.com
404-375-5496

The Breus Group
alanb@thebreusgroup.com
408-660-7071

c. Should the policy be gifted as a non-cash gift, or surrendered for cash to fund a cash donation? When a life insurance policy with a deferred gain is surrendered, the gain must be recognized by the owner as ordinary income which could put them in a higher tax bracket, resulting in higher tax rates. (See example page 24 - a taxable gain quote or a request for policy cost basis.)

The donor should consult their tax advisor to answer this question.

VIII. SUMMARY

A. A life insurance death benefit usually represents a significant amount of money – a significant asset whether personal, business or charitable.

B. Life insurance policies need to be managed with the same care and attention as other asset classes of comparable value.

C. Policy performance changes with economic conditions in non-guaranteed policies. Also, it is possible for guaranteed "When I Die" policies to have the guarantee altered through simple mistakes that can go unnoticed by the policy owner.

D. Insurance company financial strength can change, and has changed quite negatively for some companies over the past 10 years.

E. In-force policy illustrations are the cornerstone of policy management for "When I Die" policies.

F. Unneeded personal (or business) life insurance policies are a possible charitable gift source, either as a policy gift or a cash gift if the policy has a cash surrender value and is surrendered.

G. The income tax deductibility rules governing policy gifts and the income tax rules applicable at policy surrender need to be reviewed carefully with the donor's tax advisor and the nonprofit's tax advisor to properly document the gift.

H. Life insurance can also be an affordable arrangement for a donor to make a large deferred gift.

The Zimdars Company, Inc.

Insurance Sales and Consulting
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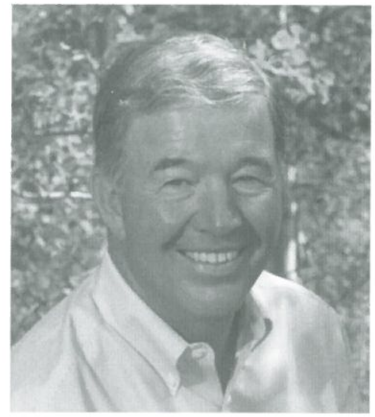

John C. Zimdars, Jr. is president of The Zimdars Company, Inc., a third generation independent life insurance consulting firm, based in Madison, Wisconsin since 1946. John has specialized in business and personal estate planning for over 35 years. His clients include individuals, closely-held businesses and professional practices.

John has an undergraduate degree in business from the University of Wisconsin - Madison. He earned his Chartered Life Underwriter (CLU) designation, his Chartered Financial Consultant (ChFC) designation, and a Master of Sciences in Financial Services (MsFS) from the American College.

John was the featured life insurance presenter at a State Bar of Wisconsin and Wisconsin Institute of CPAs nationally webcast seminar entitled "The Advisor's Guide to Understanding and Managing Life Insurance." This program was recognized by the State Bar of Wisconsin with their 2004 Best Continuing Education Course award. John has developed the Life Insurance Portfolio Management System™ to evaluate and monitor existing life insurance policies. Additional reference information on life insurance, policy management, and The Zimdars Company, Inc. is available at www.zimdars.com.

John has worked with his broker dealer, Valmark Securities, Inc., to help develop a unique and highly successful life settlement process, the Professional Life Settlement Solution™. A life settlement is the sale of an unneeded life insurance policy. It can be a valuable alternative if the settlement value exceeds the cash value being exchanged or realized on surrender.

In addition, The Zimdars Company, Inc. has been selected as a sponsor of the University of Wisconsin – Madison School of Business Family Business Center (www.fbc.wisc.edu). Discriminatory taxes, family challenges, and economic challenges make the successful perpetuation of family-owned businesses very difficult. The Family Business Center is dedicated to helping family businesses remain successful as ownership is transferred to succeeding generations.

Lynne Keppler and Vicki Rodgerson complete The Zimdars Company, Inc. team. They have combined experience of almost 50 years with The Zimdars Company, Inc. and our clients.

John and his wife, Peggy, have been married for over 30 years and have two adult sons. Peggy and John enjoy travel, and time together in Door County, Wisconsin.

John's volunteer commitments include Wisconsin Lutheran Chapel and Student Center, a campus ministry at the UW-Madison, where he currently serves on the church's governing board. He served four terms on the Board of Regents of Wisconsin Lutheran College, Milwaukee, Wisconsin and was Chairman of the Board for four years. John is a longtime member of the Madison Club finance committee, and also serves on the boards of Siebert Lutheran Foundation, Bethesda Lutheran Home Foundation, and Time of Grace Television Ministry.

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