



## LIFE INSURANCE POLICIES WITH LOANS

# The Problem...

- Many older whole life policies have accumulated large policy loans. These loans may be a result of automatic premium loans taken by the insurance carrier to cover premium costs, or they may be loaned cash value from the policy received by the policy owner.
- Due to the sustained low interest rate environment, non-guaranteed dividend rates have fallen sharply. However, policy loan rates remain unchanged.
- Policy loan rates today are often much higher than the current dividend rate. When dividend rates were 10% or higher, an 8% loan rate did not seem problematic. Now that dividends are down to nearly 5%, these policy loan rates create negative arbitrage.
- Due to the loan interest cost, policies with loan balances become very expensive to maintain.
- The loan becomes an increasing drag on policy performance and on the net death benefit payable.
- Additionally, if loans are allowed to accumulate for too long, the policy may lapse causing an enormous phantom income tax problem.



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# A Possible Solution...

- Complete a 1035 exchange to roll over both the cash value and loan balance into a universal life insurance policy (current assumption / equity indexed). This generally provides:
  - Flexibility to reduce or eliminate the policy loan balance.
  - Loan rates that are much more attractive than the existing policy loan rate.
- Some insurance carriers, through specific products, offer an attractive loan provision, which is usually at only a 1% spread for the first 10 years, and then it becomes a “wash loan.”
- M Proprietary Products with lower cost of insurance charges may provide a positive impact for a policy with a loan, resulting in less charges and “drag” on the policy performance.
- Provide a mechanism to manage and maintain coverage under a new insurance product design.
- A whole life policy can only reduce a policy loan using paid up additions. When this is done, the death benefit drops substantially and the full annual premium is still due each and every year.



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# Case Study

## CLIENT PROFILE

**Male**

AGE:

**61 years old**

OCCUPATION:

**Business Owner**

UNDERWRITING

CLASS:

**Preferred  
Non-Tobacco**

## INFORCE POLICY

DEATH BENEFIT:  
**\$1,000,000**

CASH VALUE:  
**\$600,000**

LOAN BALANCE:  
**\$350,000**

NET CASH VALUE:  
**\$250,000**

**1035  
EXCHANGE**



## NEW POLICY

**Carryover loan  
balance & cash  
value**

**Payoff policy loan  
with internal cash  
values by policy  
year 17**

**Increase death  
benefit year 1 to  
\$1,454,373**



## LIFE INSURANCE POLICIES WITH LOANS

# Illustration: Policy Values Paying Off Loan

### Policy Income Report

This table details income taken from the policy as partial withdrawals and loans. It assumes current policy charges at a Current Rate of 4.25% years 1-10, 4.75% years 11+. All values shown in this table are as of the EOY.

Policy Yr	(EOY) Age	Premium Outlay	Partial Withdrawals (a)	Loans Taken (b)	Outstanding Loan Amount	Before-Tax Income (c)=(a)+(b)	Taxes Due (d)	After-Tax Income (c)-(d)	Cash Surrender Value	Death Benefit Proceeds
1	62	600,000	0	350,000	364,000	350,000	0	350,000	208,672	1,454,373
2	63	0 *	30,000	-30,000	347,260	0	0	0	203,650	1,449,351
3	64	10,000	30,000	-30,000	330,054	0	0	0	208,112	1,453,813
4	65	10,000	30,000	-30,000	312,056	0	0	0	212,332	1,458,033
5	66	10,000	30,000	-30,000	293,338	0	0	0	216,309	1,462,010
6	67	10,000	30,000	-30,000	273,871	0	0	0	219,971	1,465,672
7	68	10,000	30,000	-30,000	253,626	0	0	0	223,245	1,468,946
8	69	10,000	30,000	-30,000	232,571	0	0	0	226,019	1,471,720
9	70	10,000	30,000	-30,000	210,674	0	0	0	228,328	1,474,029
10	71	10,000	30,000	-30,000	187,901	0	0	0	229,880	1,475,581
11	72	10,000	30,000	-30,000	162,638	0	0	0	237,284	1,470,844
12	73	10,000	30,000	-30,000	136,617	0	0	0	243,942	1,466,865
13	74	10,000	30,000	-30,000	109,815	0	0	0	249,743	1,463,666
14	75	10,000	30,000	-30,000	82,210	0	0	0	254,513	1,461,272
15	76	10,000	30,000	-30,000	53,776	0	0	0	258,013	1,459,706
16	77	10,000	30,000	-30,000	24,490	0	0	0	260,206	1,458,992
17	78	10,000	24,490	-24,490	0	0	0	0	260,756	1,458,992
18	79	10,000	0	0	0	0	0	0	259,509	1,458,992
19	80	10,000	0	0	0	0	0	0	256,064	1,458,992
20	81	10,000	0	0	0	0	0	0	249,789	1,458,992

Loan carryover

Loan payoff year 17 using policy cash values



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# Disclosures

The example provided is not representative of all clients' experiences and are not indicative of any future performance or results.

Illustrated pricing assumes indicated gender, smoking status, underwriting classes, issues ages, state of issue, interest rate assumptions, and in-force durations as specified in the presentation. To continue coverage beyond stated durations may require substantially higher premiums. Illustrated products and options shown based on product availability and pricing as of this date. Any product guarantees, including the death benefit, are subject to the claims paying ability of the issuing insurance company. This presentation is not complete without the accompanying illustrations. This information has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy. This material is intended for informational purposes only and should not be construed as legal or tax advice and is not intended to replace the advice of a qualified attorney, tax advisor or plan provider.

The policy values reflect current policy charges, current cost of insurance rates, current mortality and expense risk charges, average fund expenses and the stated hypothetical gross rate of return. The policy values are hypothetical for illustration purposes only and may not be used to project or predict investment results. Policy values will vary based on the actual performance of sub-account investments selected, actual insurance charges over the life of the plan and the timing of premium payments. Please refer to the attached illustrations for illustrated values assuming maximum policy charges and a 0% return. Loans and partial withdrawals will decrease the death benefit and cash value and may be subject to policy limitations and income tax.

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