advanced markets

I want to create wealth to leave a lasting legacy

using life insurance
as an asset

Life Insurance: · Is Not a Deposit of Any Bank · Is Not FDIC Insured · Is Not Insured by Any Federal Government Agency · Is Not Guaranteed by Any Bank or Savings Association · May Go Down in Value

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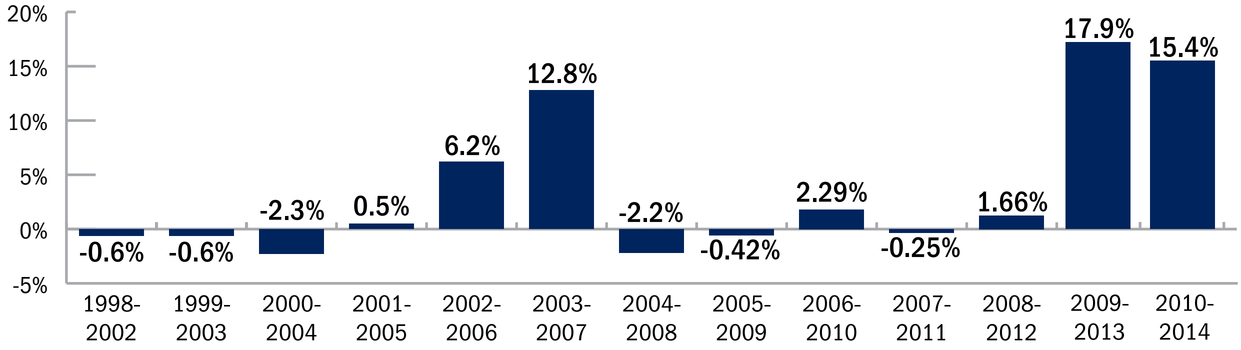
life insurance as an asset

The greatest strength of life insurance lies in the ability to provide money to a family when someone passes away. Sometimes this amount can be many multiples of the premiums that were paid into the insurance policy.

Many people think of life insurance only as a way to provide for a family after the loss of a breadwinner. But some families are also using life insurance as an "asset" to ensure that an inheritance can be passed on to their family, regardless of how their other assets perform. This is increasingly important to many families, still uneasy after the 2008 market crash and unsure of where the market is headed. The chart below shows market fluctuations in recent years, based on the five-year S&P 500® Index, without dividends.

S&P 500® Index Between 1998 and 2014



Clients cannot invest directly in the S&P 500® Index. Past performance is not indicative of future results.

By taking a portion of your assets each year to cover the cost of life insurance premiums, you may be able to hedge a portion of your portfolio against fluctuations in the marketplace, because payment comes from the life insurance company,[1] not your assets directly. Knowing that your beneficiaries will be cared for may also allow you to make other choices with your remaining assets — perhaps a more aggressive, growth-oriented strategy, or you might invest more conservatively, knowing you don't need as much growth.

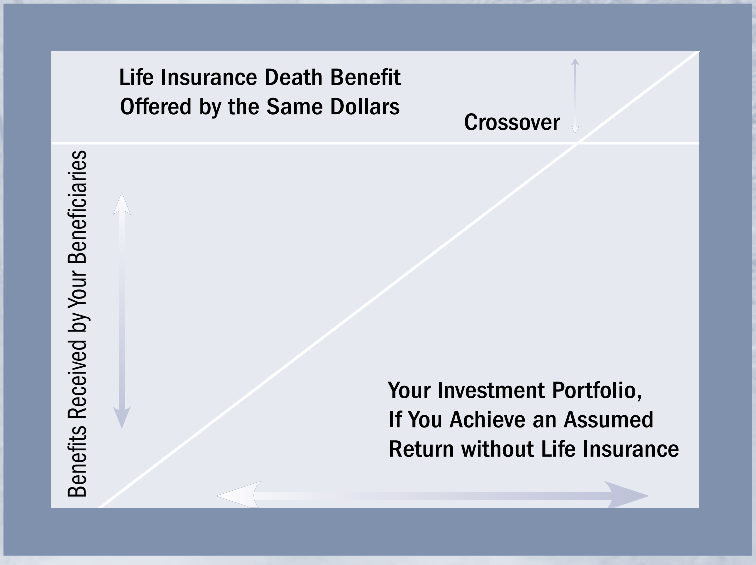
[1] The ability to receive a life insurance benefit is dependent on premium payments being made in a timely manner and the claims-paying ability of the life insurance carrier, among other factors.

how does the strategy work?

A hypothetical example of how the strategy works can be seen in the chart below. It shows what you might expect from the same dollars if they were paid into a life insurance policy as premiums, or if they were placed in a hypothetical investment account.

For you to get the most out of your policy's life insurance benefit, it has to stay in force until you pass away. If your policy ends or terminates, or if you otherwise dispose of your policy before your death, your beneficiaries would receive a substantially reduced benefit, and any proceeds they would receive could be subject to income taxation.

In the early years,[2] life insurance death benefits typically offer substantially more than the hypothetical investment. As time goes on, the leverage offered by life insurance may be reduced as the non-life insurance assets grow and compound. At some point there is a crossover, where the growth in the investment account outweighs the benefit provided by the life insurance policy. Of course, it's hard to know which strategy is more beneficial unless someone knows their precise life expectancy and whether it is before or after this crossover point.



[2] Generally, this refers to the first 20-30 years. The number of years will vary depending on the client's age, underwriting class, premium payments and other factors.

Life Insurance as an Asset: in Action

Helen

- 60 years old
- Widowed
- Portfolio[3] of $3,000,000 in real estate and equities

Helen's Objectives: Helen wants to make sure that her children and grandchildren receive a meaningful inheritance. While Helen expects to receive a 7% return on her investments over time, she is concerned that, in today's environment, the assets might underperform. For example, if her assets receive only a 5% average annual return over time, her beneficiaries might receive substantially less than her expectations. Assuming a blended income and capital gains tax bracket of 27.50%,[4] that 2% difference in return rate over 28 years could result in a difference of over $3,000,000 in the portfolio balance.

Value of Portfolio at Age 88, Pre-Tax 7% Rate of Return: $11,997,877	Value of Portfolio at Age 88, Pre-Tax 5% Rate of Return: $8,139,710

Helen's Wealth Transfer Strategy: As a hedge against that risk, Helen's financial professional suggests she take $30,000 each year, or 1% of her accessible assets, and direct the funds to a life insurance policy on her life. She can own this policy outright, although she may want to consider using a trust. If structured properly, life insurance owned by an irrevocable trust will generally keep the proceeds of the life insurance out of the insured's estate. This will prevent the proceeds from being subject to estate taxation.

Helen's Results: Assuming a policy on Helen's life (a 60-year-old female who receives an underwriting category of Preferred non-tobacco user), her beneficiaries might see the following results. Each year's life insurance premium is $30,000. That may purchase a life insurance benefit[5] of $2,400,000. Helen's portfolio is reduced slightly due to the premium expense, but the life insurance benefit gives her a potentially more effective transfer strategy.

[3] This portfolio represents a 50% Income/50% Appreciation portfolio allocation that is primarily made up of real estate and equities.

[4] This is a blended tax rate, which assumes a 35% ordinary income tax rate, a 20% capital gains tax rate and a constant 50% Income/50% Appreciation portfolio allocation.

[5] The policy premium and life insurance benefit amounts used for this case are intended only to help demonstrate the planning concept discussed and not to promote the sale of a specific product. The rates are broadly representative of rates that would apply for a policy of this type and size for insureds of good health in the ages mentioned. To determine how this approach would work for you, individual illustrations should be prepared or requested for your review. If different rates were used, there might be significantly different results.

Additionally, the death benefit will ensure a return of the funds contributed, something few other financial assets can offer.

In effect, by using her assets to buy life insurance Helen is giving up some upside potential for greater safety in her wealth transfer strategy — By directing this relatively small amount of her net worth into life insurance, she adds a stabilizing element to the dollars ultimately transferred to her family (provided the policy stays in force).

At Average 7.00% Growth				
Year-End	Portfolio without Insurance Planning	Portfolio Reduced by Life Insurance Premiums	Reduced Portfolio Plus Life Insurance Death Benefit	Difference with Life Insurance
5	$3,842,539	$3,668,096	$6,072,985	$2,230,446
10	$4,921,701	$4,523,824	$6,928,713	$2,007,012
15	$6,303,942	$5,619,880	$8,024,769	$1,720,826
20	$8.074,381	$7,023,759	$9,428,648	$1,354,267
25	$10,342,040	$8,821,912	$11,226,801	$884,761
28[6]	**$11,997,877**	**$10,134,918**	**$12,539,807**	**$541,929**
40	$21,731,875	$17,853,547	$20,258,436	-$1,473,440

At Average 5.00% Growth				
Year-End	Portfolio without Insurance Planning	Portfolio Reduced by Life Insurance Premiums	Reduced Portfolio Plus Life Insurance Death Benefit	Difference with Life Insurance
5	$3,584,627	$3,417,504	$5,822,393	$2,237,766
10	$4,283,184	$3,916,370	$6,321,259	$2,038,075
15	$5,117,872	$4,512,453	$6,912,342	$1,799,470
20	$6,115,221	$5,224,697	$7,629,586	$1,514,366
25	$7,306,928	$6,075,741	$8,480,630	$1,173,702
28[6]	**$8,130,710**	**$6,664,035**	**$9,068,924**	**$938,214**
40	$12,465,308	$9,759,535	$12,164,424	-$300,883

[6] This year indicates Life Expectancy based on the 2008 VBT Mortality Table

If Helen were to receive a lower rate of return, using life insurance could potentially help offset the risk of loss or underperformance. Through the purchase of life insurance, Helen has, at least in part, shifted the risk of underperformance from her to the insurance company.

Make a Difference with Life Insurance

Ultimately, at her life expectancy, Helen's purchase of life insurance increases the amount passing to her beneficiaries.

- If Helen continues to receive the expected pre-tax return of 7% average annual growth, her beneficiaries would gain an additional $541,929.
- If Helen receives a lower pre-tax return of 5% on her assets, the gain to beneficiaries would be $938,214. **In fact, if Helen had invested the $30,000 annual premium at a 5% return, she would have to wait until she was age 97 before the funds would grow to a level greater than the $2,400,000 life insurance death benefit.**

Other Considerations

Although using life insurance as a part of your wealth transfer strategy may make sense, you should weigh this against other considerations relative to your long-term financial strategy. Points to consider are:

- By purchasing a life insurance policy, you will consume a portion of assets that might otherwise grow in your investment portfolio. Although life insurance has the potential to offer leverage in the early years, leaving the premium dollars in your portfolio might provide more to your beneficiaries over time. This is particularly true if you live beyond your life expectancy. You should not dedicate excessive amounts of assets to life insurance. Instead, consider life insurance as only one aspect of your overall financial picture.
- The effectiveness of this technique depends on the underlying pricing assumptions in the life insurance policy. Should the life insurance fail to meet the pricing assumptions, or should you live significantly beyond your life expectancy, the anticipated death benefit may not provide your beneficiaries with the anticipated leverage.
- Your ability to purchase life insurance is conditioned by financial and medical underwriting. Based on your overall medical and financial profile, the total amount of life insurance protection you might be able to purchase could be limited or cost prohibitive.
- The ability of the life insurance carrier to pay its obligations will also affect your planning. You should be certain that you are working with a sound carrier and monitor the carrier’s overall financial ratings on a periodic basis.

You have choices.

Life insurance is one of those choices. When used properly, it can not only protect your family from the unexpected loss of a breadwinner, it can help ensure your beneficiaries a predetermined death benefit. In turn, you will have other choices for the balance of your portfolio.

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1290 Avenue of the Americas, NY, NY 10104, (212) 554-1234

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