Universal Life Insurance

An increasing number of affluent families are taking out universal life insurance (ULI) as part of their global estate planning and wealth structuring. Due to the large insured amounts, universal life insurance is also referred to as 'jumbo life insurance' or 'jumbo universal life'.

Simply put, universal life insurance is a life insurance policy that offers very high death coverage, both as a percentage (often over 300% of the premium paid; e.g. you pay a premium of USD 3 million and the beneficiaries receive USD 9 million or more at demise) and in absolute numbers (sometimes over USD 90 million), hence the label 'jumbo life insurance'.

What makes universal life insurance stand out from other life insurance products is the fact that it combines high death coverage with an actual savings component: over the years the value of the policy grows, with a guaranteed interest rate.

What is universal life insurance?

Universal life insurance is a type of life insurance that offers very high death coverage. It combines this with a savings component; the premium the policyholder pays is for the most part invested by the life insurance company to provide a cash value build-up (every policy will have a so-called Cash Value) which can be viewed by the policyholder as an alternative asset class akin to a savings account or investment product.

Universal life insurance policies are mostly used:

- as a **liquidity planning tool** in case of demise (estate planning);
- to **compensate for inheritance tax charges**, for example on foreign property (tax planning); e.g. UK inheritance tax (40%) will be applicable to the value of London real estate on the demise of the owner,
- to **plan for complex estates** with numerous family members (succession planning); i.e. to create liquidity in the context of family business succession to benefit non-active family members or to settle existing debts without liquidating businesses or investments;
- to provide **family security** – protect the family's lifestyle in the event of a tragic loss (wealth planning);
- to **avoid probate**; or
- as an **attractive alternative investment** (diversification).

Within the life insurance spectrum, universal life insurance is the exact opposite of private placement life insurance (PPLI). A jumbo life policy has very high death coverage, whereas a PPLI policy offers the bare minimum of death coverage.

How does universal life insurance work?

Traditional life insurance

In traditional life insurance premium is based on a given level of insurance cover. If the insured event happens, then the agreed insurance cover is paid out. If the insured event does not take place, or the policyholder stops paying the premium, then the sum of all premiums paid so far is lost. Premiums therefore form a pure cost for the policyholder, unless the insured event actually happens.

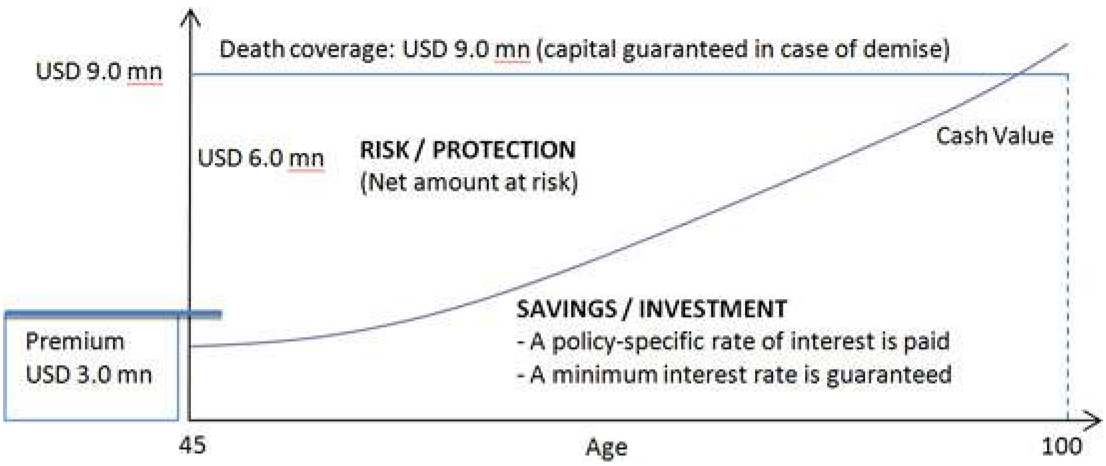
Universal life insurance

Premium paid for a universal life policy might be better termed a 'deposit'. A sizeable cash payment ('deposit') is made to the insurer to obtain the universal life insurance policy and the policyholder immediately receives the agreed insurance cover; e.g. a premium of USD 3 million is paid and the beneficiaries receive USD 9 million when the insured life passes away*. In addition, the universal life insurance company annually credits a (guaranteed) interest to this 'deposit' of the policyholder's. The insurance company calls this 'deposit' the Cash Value. It consists of the full premium a policyholder has paid, minus the costs of insurance and other costs, such as the insurance company's and the broker's fees.

* The tax consequences of a life insurance are different for every country.

So, unlike with the above-mentioned traditional life insurance, the premium paid is not lost. The universal life insurance company is able to offer interest on the Cash Value by collecting each and every deposit (from all the policyholders) on its own general investment account and investing it into investment-grade, long-term, conservative fixed-income style investments (the actual underlying investments vary slightly from one insurer to another).

Due to this long-term nature of the underlying investments, the insurers are able to pay a relatively high interest rate compared to the current average market rate. They also commit to paying a guaranteed minimum interest rate, so universal life insurance functions as an actual investment for the policyholder. The cash value will generally increase and after a number of years will exceed the premium paid (see graph).



This is an example for illustration purposes only.

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The universal life insurance policy

The universal life insurance policy may be based in different currencies but is usually denominated in US dollars. The policyholder is given flexibility for funding the insurance, with the option either of providing a lump sum deposit (single-pay) or of paying annually (multi-pay) over a number of years.

The policy itself is also highly flexible. The death coverage and beneficiaries can be reviewed and modified as the insured party's circumstances change throughout their lifetime. The policyholder is entitled to add to their premium(s) in the future.

The policyholder has full access to the savings component (Cash Value) of the policy, which can be increased, drawn down and pledged if needed. Full or partial surrenders are possible at any time: the policyholder may withdraw funds at any time from the ULI policy – perhaps to fulfil a liquidity need, or to take profits when the cash value is increasing more than the policyholder requires.

When taking out a universal life insurance policy, one needs to decide who will be the beneficiary(-ies) of that policy. This does not necessarily have to be a natural person it can also be a structure, such as a trust. Once the policy is in place it is possible to change the beneficiary provisions (alterations can be made to react to changing family circumstances or because this is necessary due to relocation to a foreign jurisdiction).

The insurance risk

Due to the high-risk component (death coverage) of ULI, affluent families wishing to purchase one have to undergo strict underwriting. This covers both medical underwriting and financial underwriting. Interested individuals are required to undergo a thorough medical assessment at an approved clinic. The insurance terms are offered on the basis of the actuarial risk assessed from this underwriting process. This may also mean that persons resident in certain jurisdictions, or of a certain age or constitution, will not be able to have terms offered at all; or only less attractive terms.

Financing the universal life insurance premium

Due to the fact that the policy has a Cash Value when it is surrendered (the Cash Surrender Value – CSV), it is possible to obtain a loan to finance a considerable part of the premium. The collateral for that loan will be formed by the issued insurance policy. Obtaining a loan at a later stage is also possible. Due to the conservative way in which the insurance companies invest, some private banks are willing to finance the premium up to 85-90% of the Cash Surrender Value, which is comparable to approximately 75–85% of the premium itself. Please note, however, that the loan would first need to be repaid to the bank before the policyholder or a beneficiary can benefit from any distribution of the policy.

This possibility creates a lot of additional wealth planning options for affluent families, especially for the ones that are **asset-rich, but short of liquidity**. By taking out financing for the policy they are able to obtain much higher death coverage.

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Simple example:

Death cover:	USD 9,000,000
Premium:	USD 3,000,000
Cash Surrender Value at day 1:	USD 2,750,000 (CSV)
Loan from bank:	USD 2,475,000 (90% of CSV)
Cash investment of the policyholder:	USD 525,000

This is an example for illustration purposes only.

Structuring ULI

Since ULI is a genuine insurance, paying large amounts, it often benefits from tax benefits in the home jurisdiction of the policyholder and/or beneficiary. Depending on the jurisdiction where the policyholder is living and the purpose of taking out a policy, a Jumbo Universal Life Insurance can be held in one's own name but is usually combined with a wealth planning structure such as a company, trust or foundation.

Jumbo Universal Life Insurance is only offered by a very select group of life insurance companies and only a handful of specialised insurance brokers provide advice on it. A few multi-family offices, private banks and specialised wealth advisors can assist you with putting the necessary structure in place.

How we support you

Whether you have any questions with regards to this subject or intend to select a multi-family office in Switzerland, or want to discuss your wealth planning in general, we very much invite you to contact us. We look forward to helping you.

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