Survivor Survivorship

Client Profile

This sales concept is appropriate where the client has an established estate plan that includes an existing second-to-die policy, and

- One of the insureds under the life insurance policy has already died,
- The surviving insured is in relatively good health, and
- The client and advisors believe that there is a remaining need for a life insurance death benefit.

Overview

A client's existing second-to-die coverage is reviewed after a first death has occurred, in order to determine whether they might be able to provide more for their heirs by converting the coverage into a single life policy.

In some cases a single life policy insuring the life of the surviving client may offer an attractive alternative to keeping the existing second-to-die policy. Utilizing the second-to-die policy values (possibly through a Section 1035 exchange) might provide much more for the client's heirs.[1]

Why Does it Work?

- Policy cash values may have increased significantly following the first death. These increased values may provide an opportunity to leverage coverage in a single life policy.
- Existing policies may be underperforming from several years of low interest/dividend crediting rates.
- New products may be more cost efficient and offer better guarantees, often allowing a policy to offer death benefits, regardless of actual portfolio performance, to age 100 or later.
- Improving health and lifestyle changes might allow for more competitive insurance to be offered on the surviving insured, despite the fact that they are now older. What was once considered rated for underwriting purposes may be standard today.
- Current coverage may be either inadequate or excessive for a client's current needs.

[1] In two private letter rulings, Let. Rul. 9248013 and Let. Rul. 9330040, the IRS noted that when a second-to-die policy was exchanged after the death of one insured for a policy insuring only the survivor, the new policy was insuring the same single life, and thus it was an acceptable Section 1035 exchange.

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Example

Phillip and Joan set up their estate plan 10 years ago. As part of the plan they set up an irrevocable trust and the trustee purchased a second-to-die policy on their lives. By insuring both Phillip and Joan, their gifts to the trust could be used by the trustee to pay premiums for a much larger death benefit than if only one of the clients was insured. By purchasing a second-to-die policy, the clients and trust were able to time the death benefit to handle estate liquidity needs.

Now, Phillip has died and Joan is the sole surviving insured. She is ten years older but still healthy. She met with her attorney and the trustee. They determined that her estate has grown over the years and that a larger death benefit might be needed. Prior to the meeting, the trustee requested an in-force projection on the current life insurance. They expressed some concern that the existing life insurance may not have performed as expected and runs the risk of a reduced death benefit if Joan lives into her 90s.

Survivor Survivorship offered the trust a larger and potentially more secure death benefit than if it simply maintained the existing policy. A Section 1035 Exchange was executed.[2]

Benefits

- Increased the death benefit available to the trust beneficiaries
- The new policy has a No-Lapse-Guarantee feature, providing death benefit guarantees[3]

[2] A Section 1035 Exchange provides that, under certain conditions, no gain or loss will be recognized on the exchange of one life insurance contract for another. The taxpayer's basis in the new policy will be the same as that of the contract exchanged. I.R.C. Section 1031(d). These provisions allow avoidance of the current recognition of gain that could result upon the surrender of an existing policy. I.R.C. Section 72(e).

[3] Guarantees are subject to the claims-paying ability of the issuing insurance company.

Cash value built up in the original policy may be applied to the new life insurance policy's first year expenses, including commissions.

An investor will pay higher premiums given that fact that he or she is older than when the existing policy was purchased. This is especially so if the investor's health has declined.

Life insurance policies often include surrender charges, which can reduce the amount of cash value available toward the new policy. Moreover, the new policy will likely have its own new surrender charge schedule, which may extend beyond that of the original policy.

The new policy typically will have a new contestability period - a two-year period from the issuance of the new policy during which the insurance company could challenge a death claim based upon a misstatement on the application.

There may be unfavorable tax consequences caused by surrendering an existing policy, such as a potential tax on outstanding policy loans.

For traditional insurance products only; may not be used with variable life policies. Riders are available for an additional cost. Any guarantees offered by life insurance products are subject to the claims-paying ability of the issuing insurance company. There are considerable issues that need to be considered before replacing life insurance such as, but not limited to: commissions, fees, expenses, surrender charges, premiums and new contestability period. There may also be unfavorable tax consequences caused by surrendering an existing policy, such as a potential tax on outstanding policy loans. Please discuss your situation with your financial advisor.

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