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- Part III: Threats to Independents
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- Life Insurance A-Z Poster
- Best Apps for Producers

LIFE INSURANCE AS
ASSET PROTECTION

Illustration by Oliver Winward

High cash value life insurance can provide a creditor-protected alternative to cash for your high net-worth clients.

By Ike Devji, J.D.

The last five years have produced an explosion in the number of clients looking for solutions to both asset protection and estate planning issues. Your high net-worth (HNW) clients are rightly more concerned than ever before with loss than growth.

That's due to a variety of factors threatening their wealth, including increased litigation risk, decreased compensation and earnings, stalled or negative investment momentum and, of course, the uncertainty surrounding pending estate tax increases at the end of this year. Thanks to the laws in many states that protect the cash value of life insurance policies, you can now be part of a solution to these exposures.

In many states, like Texas, Florida, New Mexico and Hawaii, life insurance is creditor-protected by statute — including, in some cases, bankruptcy exemption statutes — to an unlimited dollar amount. Most states have specific guidelines and definitions as to how the policies are structured in terms of owners and beneficiaries, and the level of protection varies widely from state to state.

By using these statutes, you can convert exposed assets (cash) subject to creditor risk to protected assets with a death benefit. For most advisors, consulting with an attorney well-versed in these statutes or able to explain the required policy structure is advised. Be careful of what you find online from third parties; it is often outdated or glosses over important details.

The trouble with cash

But why would anyone consider allocating cash to insurance? There are several good reasons.

Cash is at an all-time high. Even with the threats to wealth outlined earlier, we have more liquid wealth on the sidelines than ever before (trillions of dollars in cash, by some accounts) due to the perceived current instability of both the stock market and real estate. In most cases, even for legally and financially sophisticated people, this cash is unprotected and exposed to any source of creditor risk or liability.

Bank solvency risk continues. A recent report sheds light on the health of the banking industry, and it's not good. Due to continuing losses incurred in the commercial real estate market, as many as 200 banks remain at risk of imminent failure. Due to the abnormally high amounts of cash clients are sitting on, the possibility of relying on FDIC insurance limits is more real than ever before. Yet, few have taken the time to spread accounts and balances out to be within the $250,000 insurance limit the FDIC provides. Worse, many professionals I deal with, including a former bank president in the Southwest, have described that limit as a placebo. They believe the FDIC would actually be insolvent in the event of a major run on the banks. If you remember correctly, the limit was increased to $250,000 only four years ago to prevent such a run.

Cash is producing near zero returns. Due to the historically low rate of return, money funds are yielding an average of only 0.03%! The highest-yielding one-year bank CD, from CIT bank, yields 1.1%, according to Bankrate.com — that's a mere $5,500 a year from a $500,000 deposit. With some high cash value policies having first-year values of up to 102%, life insurance is now a credible alternative.

So what types of policies make good "cash alternatives"? Look for these qualities:

- Full/high cash value in year one (These policies do exist.)
- No surrender charges or lagging cash value (true cash equivalent)
- A high death benefit to prove up the legitimate business purpose (We've seen up to 10 times death benefit on the right policies.)
- Ability to access cash value through policy loans and to collateralize
- Ability to allocate to a "segregated account" that protects your client from real or perceived solvency risk of the carrier itself

When this strategy doesn't work

Like any strategy that includes an asset protection concern, timing is king. Clients who have an existing lawsuit or other creditor exposure usually can't make an 11th hour move into a structure like this and claim safety in most states.

Also, as the strategy is insurance-based, it requires an insurable policy owner. In many cases, the spouses of HNW individuals are underinsured, have additional capacity and are often healthier, so don't overlook using a spouse instead of (or in addition to) the primary insured. Finally, we have advisors who over-reach by stuff-

"The best advisors take the time to determine exactly how much 'emergency cash' a client always wants to have on hand at any given time and finds ways to protect that reserve amount."

ing too much cash into a policy like this, which sets themselves and the clients up to fail. The best advisors take the time to determine exactly how much "emergency cash" a client always wants to have on hand at any given time and finds ways to protect that reserve amount. It's not ideal to use the entirety of clients' cash holdings, which they are more likely to need for emergency and opportunity.

This merely scratches the surface of this tactical application of life insurance in a non-traditional way. Hopefully it sheds a little light on how a client, attorney or financial advisor you work with may benefit from using the right life insurance policy to create a stable and liquid cash alternative in a hostile economic climate.

Ike Devji, J.D., is an asset protection-only attorney with nearly a decade of experience in helping to protect a national client base of thousands, representing more than $6 billion in assets. He is a regular author and educator on this subject and works closely with advisors, GAs and broker-dealers nationally to help them serve HNW clients, like physicians, executives and business owners. Reach him at id@thewealthy100.com, and see more on asset protection and this strategy at www.proassetprotection.com and www.thevalutstrategy.com.