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Waldron Private Wealth

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“Demystifying private placement life insurance: what are the pros and cons?”

By Michael Krol

Private placement life insurance, or PPLI, has been a buzzword in the circles of high net worth investors and professional advisors for years. The allure of the exceptional tax benefits PPLI can provide keeps it in the conversation, but the complexity of this niche product discourages its use.

The decision to execute a PPLI strategy is multifaceted, requiring integration with a high net worth investor's entire financial picture and a thorough understanding of what he or she is truly trying to achieve. Depending on the particular situation, PPLI can be a tremendous intragenerational wealth-transfer vehicle—or a fee-laden wealth drain.

PPLI as a wealth transfer vehicle: The key to using PPLI to garner significant tax advantages in a wealth transfer strategy lies in both the product structure and its position within the overall wealth-transfer plan. From a product structuring perspective, the emphasis should be on the underlying investment portfolio, with a de-emphasis on the death benefit. The implementation of this type of structure will fail if the policy permits tax-free access to cash value, which is frequently touted as one of the product's primary benefits.

Within the context of an intragenerational wealth transfer plan, PPLI can only be effective as a part of the overall strategy. In an optimal scenario, the investor should have a net worth in excess of \$50 million, along with significant liquidity. In this case, the PPLI policy can represent the appropriate portion of an overall strategy that is effective from an investment, cost, income tax and estate planning perspective.

PPLI as a wealth drain: There are a number of features of PPLI which, if not structured appropriately, can end up having a negative impact on a family's overall wealth. At the heart of this issue is the fact that the income tax benefit must outweigh the incremental product fees associated with the PPLI policy. As mentioned, there are product-structuring considerations within PPLI products that can facilitate a significant reduction of the various underlying fees.

In assessing the income tax benefit, an oversimplified analysis can neglect important considerations, such as cost-basis step-up and tax-efficient portfolio management. While difficult to measure and analyze, these considerations can make it significantly more difficult for the PPLI tax advantages to outpace the incremental fees.

From an investment management perspective, only investments that make sense outside of a PPLI product will make sense inside it. In other words, the overall investment portfolio design is the priority. Once this has been developed, a secondary analysis of which, if any, investment classes would be more tax-efficient in a PPLI product should be conducted. Simply said, the PPLI “tail” cannot wag the investment “dog.”

Strategy enhancement—not strategy solution: Like the people of Troy who invited the Trojan Horse into their city walls, ultimately leading to their demise, advisors and high net worth investors might invite any number of financial products into their financial lives based on how it looks on the surface without considering what is lurking underneath.

The biggest mistake that investors and advisors make is viewing PPLI as a standalone solution that can solve many issues, without careful consideration of the ripple effects PPLI may cause in the other areas of their financial lives: investments, estate planning, cash flow and taxation. In certain situations, with the right strategy and proper structuring, PPLI has the potential to greatly enhance an overall wealth transfer plan. ☺

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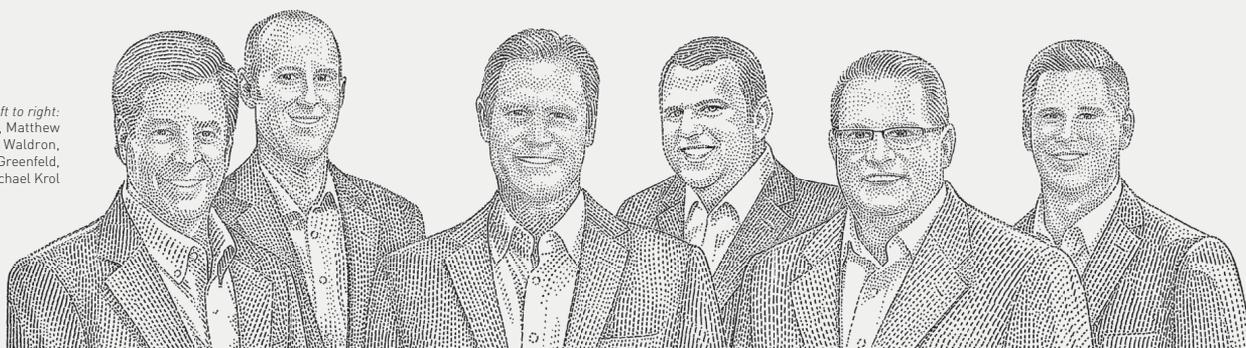
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—Michael Krol

How to reach Waldron Private Wealth

You can reach Waldron at 412.221.1005, and we would be happy to discuss our process and approach with you.

Left to right:
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About Waldron Private Wealth

Waldron Private Wealth is a boutique private wealth management firm that advises a select group of high net worth individuals, families and family offices. By limiting the number of clients it serves, Waldron can offer greater focus on how to best simplify the complexities of significant wealth, so all clients can achieve what’s important in their lives. Waldron’s advisory team is prepared to serve its clients across a wide range of key financial disciplines. The advisory team includes: three CPAs, seven CFPs, an attorney, a certified divorce financial analyst and three members holding certificates from the Institute for Preparing Heirs.

Financial Services Experience
112+ years (combined)

Assets Under Management
\$1.1 billion (as of 12/31/2014)

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
\$5 million

Largest Client Net Worth
Confidential

Compensation Method
Asset-based (investment services), hourly and fixed fees

Primary Custodians for Investor Assets
Fidelity Family Office Services and Pershing

Professional Services Provided
Planning and investment advisory services

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