Help Mitigate Risk in a Client's Financial Strategy

MIDLAND NATIONAL® Life Insurance Company | Life

Death Risk

Have you overlooked a risk to your clients' overall financial strategy? It's a risk that's hidden in plain sight, because it's wrapped around a subject no one wants to think about. Death.

Life insurance is unique for its ability to provide cash at the time that it might be needed most – when income is interrupted due to death.

Life insurance can provide needed cash, so that beneficiaries can take their time to sell liquid assets such as a business or real estate. On the other hand, it can also help prevent the forced sale of assets and help pass those assets down to the next generation.

Yet there are other risks to your clients' financial strategy that life insurance may help mitigate. This whitepaper examines the various risks that are often overlooked, as well as a potential solution that you and your clients should examine closely. A good wealth transfer strategy can help address multiple risks including those discussed in this paper.

> ***Key Point:*** Death is an inescapable risk. Yet, it is only one of the risks that life insurance can address.

Serious Illness Risk

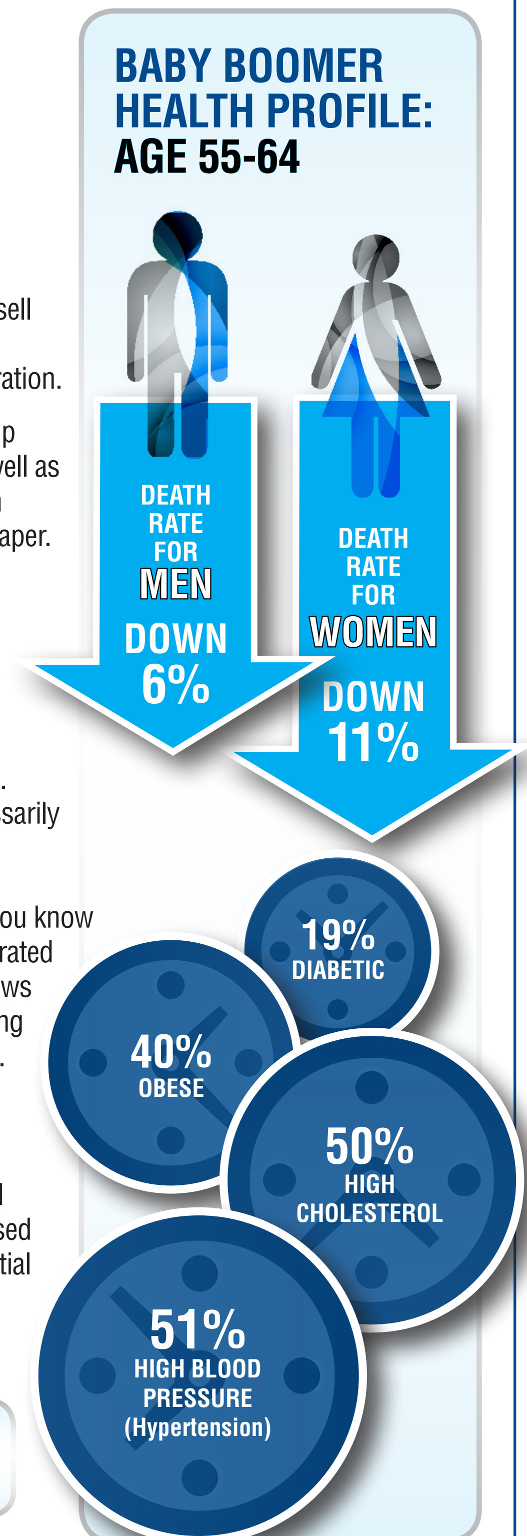
Here's the good news: Baby Boomers are living longer than the previous generation. Here's the bad news: according to the Centers for Disease control, they aren't necessarily living healthier.

Needs evolve with age. Have your clients' financial strategies evolved as well? Did you know that a life insurance death benefit could help while your clients are living? An accelerated death benefit can provide cash for a serious illness without liquidating assets. It allows the policyowner to receive a portion of the death benefit if the insured has a qualifying illness.[1] Plus, it's an unrestricted benefit — the money can be used for any purpose. Would your clients need to sell assets to cover the cost of extended nursing care or the high cost of treatment?

The unexpected can and does happen. How do your clients plan to pay for extended nursing care for a chronic condition or the high cost of treatment if they are diagnosed with a critical illness like cancer? If they plan to use their own funds, keep the potential costs in mind. Here are some of the costs your clients might expect to pay:

- Private room in a nursing home –$91,250 per year[2]
- Average out of pocket expenses for cancer patient – $712 per month[3]

> ***Key Point:*** People are living longer, but not necessarily healthier. Would your clients need to liquidate assets to pay today's high cost of care?



Centers for Disease Control and Prevention. Health, United States, 2014. (May 2015).

Opportunity Risk

Many clients have money that is "stranded" in low-interest bearing accounts for which they don't have an immediate use in mind. Clients may have a goal of long-term growth to benefit their families, or the funds may represent important assets for an emergency or other future liquid need. Permanent life insurance can be an attractive alternative to the low-interest bearing account.

It may be possible to use permanent life insurance to "rescue" the stranded money from the low-interest account and provide a valuable solution to meet your clients' short and long-term needs. The advantages of permanent life insurance include:

- Leveraging a single premium into a larger, generally income-tax free death benefit[4]
- Control and access to cash value for unexpected or immediate needs[5]
- Access to a portion of the death benefit for living needs[1]
- Potential growth of cash value

Key Point: Permanent life insurance could leverage dollars held in a low-interest bearing account into a larger generally income-tax free death benefit.[4]

There are two main criteria for identifying clients that may be affected by opportunity risk.

1. Death Benefit Need – The client has limited or no life insurance coverage. Be sure to conduct a thorough needs-based analysis and determine if death-benefit coverage is necessary before proceeding.

2. Stranded Money – The client has funds that are no longer meeting their current needs. These funds may be in savings, Certificates of Deposit (CDs)[6], annuities[7] or other vehicles. Each of these vehicles serves a purpose, so the critical question to ask is whether or not your clients' needs have changed. Additionally, it's important to remember that removing funds from a CD or annuity may result in penalty, surrender charges, or income taxes.[4]

Probate Risk

Do you think your clients can name off all of their financial assets and their values? How about the beneficiaries for each of those assets? Many people have a potpourri of financial assets, and it can be confusing at times to keep track of them. If it is hard for your clients, it's likely it will be hard for their beneficiaries as well. The Federal Reserve's Survey of Consumer Finances[8] found that as people age and as they gain wealth, their financial holdings grow more complex.

Managing the Complexity

The first step to managing the complexity of your client's financial holdings is to create a will. A will allows your client to control how and to whom assets are distributed, and can be used to suggest a guardian for the care of children or other dependents. Without a will in place, state inheritance laws could determine how your client's property is distributed, and even who should care for the children. However, even with a will, assets may not always transfer immediately to beneficiaries. There are many circumstances that can impede the process – the most common being probate court.

Probate

Probate is a court process where a judge will decide the validity of a will. This process can take anywhere from a few weeks to a few years depending on the complexity of the will, and whether potential beneficiaries contest the validity of the will. Also, generally any assets titled solely in the deceased's name (not jointly held) and don't have a beneficiary designation will go through probate.

There are some financial assets that are exempt from the probate process, ensuring that funds get to the beneficiaries more quickly. Life insurance, by its very nature, has a clear beneficiary designation and passes to that beneficiary outside of the probate process. Retirement accounts such as 401(k), IRA, and pensions may also have beneficiary designations. Jointly held assets generally bypass the probate process.

Key Point: Structuring your client's assets to minimize the number of items and total dollar value that will need to go through the probate process can save time and hassle for the executor of the will.

Beneficiary Risk

While it's possible for many types of assets to bypass probate when a beneficiary has been named, there are pitfalls to avoid. Your client may have wonderful intentions when selecting a beneficiary, yet making the wrong designations can have unintended negative consequences.

1. **Not naming a beneficiary.** Without a beneficiary, the account will be subject to probate and the state will determine how to distribute the money.
2. **Not updating beneficiary elections after marriage, divorce, or remarriage**. Make sure your client isn't unintentionally passing money to an ex-spouse, or an ex-spouse's children, or a new spouse's children, instead of their own children.
3. **Naming minor children as beneficiaries.** A minor child cannot legally own assets. Consider passing the assets into a trust that can be distributed at an age your client chooses.
4. **Naming a mentally disabled person as beneficiary.** The disabled person may lose government assistance if he or she receives the benefit directly.
5. **Not reviewing beneficiary designations on a regular basis.** Things change as life progresses. Make sure your client's beneficiary designations match today's needs.

Key Point: As part of the wealth transfer planning process, help your clients review the beneficiary forms for each of their financial assets.

Client Risk

According to *InvestmentNews* $30 trillion will be passed down from Baby Boomers to younger generations over the next 30 years. Sixty-six percent of children fire their parents' financial advisers after they inherit their parent's wealth.[9]

Developing a wealth transfer strategy provides you the opportunity to educate the client's beneficiaries on how to manage the wealth. It's more than just keeping assets under management, taking the relationship deeper shows them that you care about the future success of the family. Seventy percent of family money disappears by the end of the second generation. You can help them from becoming part of that statistic. You also would be overcoming the odds. Eighteen percent never meet with their clients' children and 54% meet with them less than annually.[9]

Key Point: Meet with your clients' children (and other beneficiaries) about wealth transfer strategy.

The Life Insurance Solution

There are several advantages of using life insurance to help build a legacy and transfer wealth to the next generation.

Risk	The Advantage of Life Insurance	How Life Insurance Helps
Risk of Death	Immediate death benefit protection	Only life insurance provides death benefit protection that can be there when your clients' loved ones need it most.
Serious Illness Risk	Accelerated Death Benefit	The policy may include the ability to accelerate the death benefit should the insured be diagnosed with a qualifying serious illness.[1]
Opportunity Risk	Leverage	Purchasing life insurance can create an immediate increase in the client's estate value in the form of a generally income-tax free death benefit.
Probate Risk	Probate-free	When your clients complete a beneficiary designation on their life insurance policies, the client's privacy can also be protected from the complexity of probate.
Beneficiary Risk	Generally income tax-free transfer to beneficiaries	When the insured passes away, the death benefit passes generally income tax free to beneficiaries.[4] Having the right beneficiary designation can help save time and money, and help relieve stress.
Client Risk	Liquidity	Premium payments into a cash value life insurance policy may accumulate cash value on a tax-deferred basis.[12] Through policy loans and withdrawals,[5] the cash value may be used as an emergency fund.

Considerations

There are also some considerations of using permanent life insurance such as:

- **Cost of insurance charges (COIs) or other charges:** Life insurance comes with charges that you and your client need to be aware of for planning purposes.
- **Loss of premium:** Depending on funding, life insurance may not guarantee avoiding loss of premium.
- **Maintaining the death benefit:** Additional premiums may be necessary to continue the desired death benefit, depending on funding.
- **Modified Endowment Contracts (MECs):** MECs may have tax implications that you and your client need to take into consideration.[10]
- **Surrender charges:** Withdrawals may be subject to surrender charges and the amount available for policy loans.

Midland National's XL-EC5

Many of Midland National's permanent life insurance products can fulfill the needs of a wealth transfer client. However, one product in particular stands out for clients that require their policy to have more liquidity. Midland National's XL-EC5 indexed universal life has a waiver of surrender charge option.[11] For an additional charge per $1,000 of coverage (depending on issue age and underwriting class), Midland National will waive the surrender charge, creating the opportunity for the policy to build net cash value quickly.

Case Study – Mary

Mary is a 60-year-old widow with slightly less than average health. She feels she has enough funding through her pension as a city government worker and her late husband's retirement account to live comfortably during retirement. Her husband had also saved $100,000 in a savings account. Mary wants to leave this money to her family, but would like to continue to grow the money and keep access to it "just in case." While her husband did have some life insurance, Mary does not have a policy on herself. She desires to not only make sure her final expenses are covered, but desires to leave a legacy to her children while minimizing the amount of assets that will need to go through probate proceedings. Mary and her agent performed a needs analysis and determined that an XL-EC5 policy would fit her needs.

Mary uses the $100,000 in the savings account to purchase an XL-EC5 indexed universal life insurance policy with a death benefit just under $233,705.[10] Single premiums will generally create a Modified Endowment Contract (MEC), which is not necessarily undesirable for a Wealth Transfer strategy. The tax treatment for a MEC is the same as other popular options for wealth transfer, such as an annuity or qualified plan. The death benefit immediately increases the value of her estate. Indexed universal life policies provide the opportunity for tax-deferred growth[12] of the policy's cash value based on the upward movement of an index without the risk of investing directly in the market. Here are some of the features that help make XL-EC5 a good choice.

- **Zero Percent Floor –** Interest credited is never less than zero percent. The index account can't lose money due to poor index performance. Interest crediting is also subject to a cap.
- **Minimum Account Value –** The Minimum Account Value is a guaranteed 2.5% average annual interest crediting rate. Every 10 years, Midland National evaluates the account value. If the account value is less than the Minimum Account Value, we will increase the Account Value to match the Minimum Account Value.
- **No premium load** *plus* a waiver of surrender charge option[11]. This combination creates more potential for the policy to accumulate cash value quickly.
- **Table Shaving —** When the Waiver of Surrender Charge Option is elected, Table Shaving may also be available. Table Shaving allows certain substandard underwriting ratings to be improved to a "standard" rating. This rating involves lower life insurance charges than substandard ratings, which can result in a higher death benefit for less premium.[13]
- **Accelerated Death Benefit —** Mary may have the ability to accelerate a portion of the death benefit should she develop a qualifying illness. She could use these funds for any purpose.[1]

Case Study – Mary

Sample Illustration Excerpt

Table shaving from Table C to Standard makes wealth transfer solution possible even with some health concerns.

Death benefit is immediately over **double** the value of the original savings account.

Midland Nati[illegible]ance Company

One Sammon[illegible]alls, SD 57193

XL-EC5
Issue State: South Dakota

Female 60 Non-Tobacco – Mary Client
Initial Specified Amount: $233,700

<u>This illustration reflects the following:</u>
Premium Allocations: S&P500® ann pt to pt 100%
Death Benefit Qualification: Cash Value Accumulation Test
Modified Endowment Contract in year 1
Extra risk charge of 75%. – the rating has been improved to standard.
Waiver of Surrender Charges
Riders, as listed on the last page

The maximum illustrated is 6.69%, which is based on a historical look back. This illustration uses a lower rate to be more conservative.

Using the min. interest rate and max. charges, nearly $100K is available at the end of the first policy year.

With waiver of surrender charge, cash value available for emergency fund.

					INTEREST AND COST SCENARIOS					
					Guaranteed Maximum Charges 3.00% Guaranteed Interest for all premiums			**Non-Gua[illegible]nteed Illustrated B** Current Charges Index Credits: 6.00% **		
End of Yr	Age	DB Opt	Annualized Premium Outlay	Type*	Account Value	Net Cash Surrender Value	Death Benefit	Account Value	Net Cash Surrender Value	Death Benefit
1	61	1	100,000.00	E	99,5[illegible]	99,509	233,700	104,283	104,283	243,710
2	62	1	0.00		98,905	98,905	233,700	108,403	108,403	246,292
3	63	1	0.00		98,184	98,184	233,700	112,546	112,546	248,615
4	64	1	0.00		97,341	97,341	233,700	116,811	116,811	251,028
5	65	1	0.00		96,338	96,338	233,700	121,164	121,164	253,355
6	66	1	0.00		95,185	95,185	233,700	125,221	125,221	254,825
7	67	1	0.00		93,839	93,839	233,700	129,372	129,372	256,287
8	68	1	0.00		92,293	92,293	233,700	133,6[illegible]	133,631	257,774
9	69	1	0.00		90,499	90,499	233,700	138,023	138,023	259,484
10	70	1	0.00		88,445	88,445	233,700	142,618	142,618	261,278
			100,000.00	E						
11	71	1	0.00		86,061	86,061	233,700	148,708	148,708	265,594
12	72	1	0.00		83,326	83,326	233,700	155,012	155,012	270,032
13	73	1	0.00		80,159	80,159	233,700	161,575	161,575	274,678
14	74	1	0.00		76,509	76,509	233,700	168,366	168,366	279,489
15	75	1	0.00		72,463	72,463	233,700	175,600	175,600	284,649
36	96	1	0.00		0	0	0	488,417	488,417	546,539
37	97	1	0.00		0	0	0	510,696	510,696	562,788
38	98	1	0.00		0	0	0	533,414	533,414	584,622
39	99	1	0.00		0	0	0	557,140	557,140	607,840
40	100	1	0.00		0	0	0	582,002	582,002	631,473
			100,000.00	E						

At age 100, we will no longer accept any premiums and there will be no further charges or deductions.
Amounts shown in the Outlay column are annualized, but are illustrated based on the following frequency:
* E = Extra Premium

**Illustrated Index Credits (including bonuses)
6.00% years

The information presented is hypothetical and not intended to project or predict investment results. Illustrations are not complete unless all pages are included.

For most policies, withdrawals are free from federal income tax to the extent of the investment in the contract, and policy loans are also tax-free so long as the policy does not terminate before the death of the insured. However, if the policy is a Modified Endowment Contract (MEC), a withdrawal or policy loan may be taxable upon receipt. Further, unpaid loan interest on a MEC may be taxable. A MEC is a contract received in exchange for a MEC or for which premiums paid during a seven-year testing period exceed prescribed premium limits (7-pay premium).

Next Steps

Think about your clients and whether you have an opportunity to help maximize the wealth they leave behind while minimizing the hassle for the beneficiaries. Here are some steps you may want to consider taking.

1. **Identify your client's death benefit need and establish whether a Wealth Transfer strategy is appropriate.**
2. **Review your client's financial assets and develop a strategy.** Structuring your client's assets to minimize the number of items and total dollar value of assets that have to go through the probate process can save time and hassle for the executor of the will.
3. **Meet with your client's children to discuss the strategy.**
4. **Consider moving some of your client's assets to a permanent life insurance policy, such as Midland National's XL-EC5.** An XL-EC5 policy could leverage dollars that would have been "stranded" in a low-interest bearing account into a larger death benefit, while maintaining liquidity for emergencies.[5]

Need help mitigating risk in your client's financial strategy? Contact Midland National.

Sales Support: 1-800-843-3316 ext. 32150

1. Subject to eligibility requirements. The death benefit will be reduced by the amount of the death benefit accelerated. Since benefits are paid prior to death, a discount will be applied to the death benefit accelerated. As a result, the actual amount received will be less than the amount of the death benefit accelerated. An Administrative fee is required at time of election for chronic and terminal illness at time of election. There is no administrative fee for a critical illness election.

ACCELERATED DEATH BENEFITS ARE NOT LONG TERM CARE INSURANCE NOR IS IT INTENDED TO REPLACE LONG TERM CARE INSURANCE. THIS IS NOT HEALTH OR DISABILITY INSURANCE NOR IS IT INTENDED TO REPLACE HEALTH OR DISABILITY INSURANCE.

Agents offering, marketing, or selling accelerated death benefits for chronic illness in California must be able to describe the differences between benefits provided under an accelerated death benefit for chronic illness and benefits provided under long-term care insurance to clients. You must provide clients with the ADBE Consumer Brochure for California Form 20501 that includes this comparison. Comparison is for solicitation purpose only, not for conversions.

2. Source Genworth 2015 Cost of Care Survey, March 2015. Median cost is quoted.

3. Source: Cancer's Growing Burden: The High Cost of Care," USA Today, Feb. 12, 2012.

4. Neither Midland National nor its agents give tax advice. Please advise your customers to consult with and rely on a qualified legal or tax advisor before entering into or paying additional premiums with respect to such arrangements.

5. In some situations, loans and withdrawals may be subject to federal taxes. Midland National Life Insurance Company does not give tax or legal advice. Clients should be instructed to consult with and rely on their own tax advisor or attorney for advice on their specific situation.

Income and growth on accumulated cash values is generally taxable only upon withdrawal. Adverse tax consequences may result if withdrawals exceed premiums paid into the policy. Withdrawals or surrenders made during a Surrender Charge period will be subject to surrender charges and may reduce the ultimate death benefit and cash value. Surrender charges vary by product, issue age, sex, underwriting class, and policy year.

6. Removing funds from a Certificate of Deposit may result in penalty.

7. Removing funds from an annuity may result in surrender charges and/or income taxes.

8. The Federal Reserve. 2013 Survey of Consumer Finances, Table 6-13. September 2014. http://www.federalreserve.gov/econresdata/scf/scfindex.htm

9. Skinner, Liz. The Great Wealth Transfer is Coming, Putting Advisers at Risk. InvestmentNews. July 2015. http://www.investmentnews.com/article/20150713/FEATURE/150719999/the-great-wealth-transfer-is-coming-putting-advisers-at-risk

10. For most policies, withdrawals are free from federal income tax to the extent of the investment in the contract, and policy loans are also tax-free so long as the policy does not terminate before the death of the insured. However, if the policy is a MEC, a withdrawal or policy loan may be taxable upon receipt. Further, unpaid loan interest on a MEC may be taxable. A MEC is a contract received in exchange for a MEC or for which premiums paid during a seven-year testing period exceed prescribed premium limits (7-pay premium).

11. Available for an additional charge per $1,000 per month, depending on issue age and underwriting class. Surrender charges will be waived upon a full surrender, partial surrender or a Death Benefit Option change if the Waiver of Surrender Charge option is elected. Surrender charges will not be waived if the policy is surrendered under a 1035 Exchange (except in FL). A decrease charge will be assessed if a reduction in the policy face amount is requested during the Waiver of Surrender Charge Period. However, if a partial withdrawal results in a reduction of the face amount, the withdrawal charge is waived.

12. The tax-deferred feature of the indexed universal life policy is not necessarily for a tax-qualified plan. In such instances, your client should consider whether other features, such as the death benefit and optional riders make the policy appropriate for your client's needs. Before purchasing this policy, your client should obtain competent tax advice both as to the tax treatment of the policy and the suitability of the product.

13. When a person applies for life insurance coverage, his or her health is evaluated and a corresponding underwriting rating is applied. This product's table shaving feature allows certain substandard underwriting rates (known as "table ratings") to be improved to a "standard" rating. A "standard" rating generally indicates average health and involves a lower life insurance premium than do substandard ratings.

Indexed Universal Life products are not an investment in the "market" or in the applicable index and are subject to all policy fees and charges normally associated with most universal life insurance.

XL-EC5 (policy form series L144 and L144W with the Waiver of Surrender Charge), is issued by Midland National Life Insurance Company, Administrative Office, One Sammons Plaza, Sioux Falls, SD 57193. Products, features, endorsements, riders or issue ages may not be available in all jurisdictions. Limitations or restrictions may apply.