# Understanding the Private Insurance Portfolio

## Introduction

Many international investors spend hefty amounts of time and money to structure THE solution for their long-term wealth protection plans. Oftentimes, complex legal structures are set up in remote offshore jurisdictions you can hardly pronounce in pursuit of that goal.

The plan must provide for maximized tax efficiency, solid asset protection, and access to the world's best investment markets for attractive returns.

Most investors come to the conclusion that the optimal solution is not available, does not deliver the desired results, or is simply not affordable. But for affluent investors, one such option does exist that achieves ALL of the aforementioned goals.

A Private Insurance Portfolio (sometimes referred to as a Portfolio Bond, Private Placement Life insurance, or "insurance wrapper") combines a bank account, a brokerage account and an insurance policy under one asset-protected umbrella.

## Overview of Benefits

1. **Tax-Efficient:** A Private Insurance Portfolio offers tremendous tax benefits available from few other investment vehicles without the need for expensive and complex trust structures:

   - Tax-inefficient assets can grow tax-deferred
   - Investment gains can be free of all income tax
   - Elimination of tax obligations on reinvestment
   - Income tax-free death benefit for the Estate
   - Potential to exclude from Estate taxes
   - Favorable tax treatment on loans and withdrawals

   The tax efficiency obtained will depend on the tax laws of the Client's domicile. In most jurisdictions, our strategies will achieve tax deferment if not total tax elimination regarding income taxes, capital gains taxes as well as estate taxes.

2. **Asset Protection:** A Private Insurance Portfolio's key goal in asset protection is to provide protection from creditors and/or litigants arising from unforeseen, adverse events. The insurance companies we work with are amongst the safest in the world and are domiciled in jurisdictions that provide the highest levels of protection from creditors, frivolous lawsuits and government confiscation.

   Additionally, unless otherwise required by law or directed by the policyowner, the relationship between an international insurance company and a policyowner is held in strict confidence under the laws governing the insurance company.

3. **Global Investment Flexibility:** A Private Insurance Portfolio is a holding structure through which you, in conjunction with a professional advisor, can request that the insurance company invest in nearly any investment vehicle.

   A Private Insurance Portfolio supports an array of high-return, wealth-creating assets such as hedge funds, private equity or venture capital, which are wholly unavailable through traditional insurance solutions.

   In addition, the portfolio may be denominated in your currency of choice. Underlying accounts and assets may be denominated in most world currencies.

   Finally, some Private Insurance Portfolio's allow for the insertion of existing assets and portfolios rather than cash (Premium in-kind). You needn't sell your assets in order to fund your strategy. This feature facilitates a variety of sophisticated planning techniques, for instance those required for the transfer of highly appreciated assets.

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## Tax Planning

Unlike many offshore investments and structures, Private Insurance Portfolio's are, in certain jurisdictions, completely free of taxes. As far as income, capital gains, estate or withholding taxes are concerned, the law of the investor's tax domicile is decisive. In many countries insurance policies enjoy substantial tax benefits if correctly structured, i.e., the Private Insurance Portfolio can be tailor-made to fit the legal requirements for privileged tax treatment. For U.S. persons this includes:

- Tax deferral during the insured's life. The inside build-up of the Private Insurance Portfolio is generally income and capital gains tax-free. For U.S. individuals and corporations with assets abroad, using a Private Insurance Portfolio as a holding structure for these assets provides an efficient mechanism for sidestepping the 31% withholding tax on income and gains from U.S. assets held in foreign accounts.
- No income taxes on insurance proceeds. At the policyowner's death, the insurance proceeds are generally income tax exempt.
- No estate taxes on insurance proceeds. With proper planning (such as through the use of an irrevocable life insurance trust) insurance proceeds can avoid estate taxation at the death of the insured.
- No U.S. excise taxes under certain conditions. Unlike many other foreign insurance policies, Swiss policies are not subject to the 1% U.S. excise tax on the purchase of foreign insurance policies. This is a by-product of the adoption in 1998 of a revised Swiss-U.S. Double Tax Treaty and applies for premiums paid by a US citizen to an insurance company domiciled in Switzerland. Liechtenstein insurance companies are not "favored" by a similar tax treaty; Liechtenstein contracts are therefore subject to the excise tax. On the other hand, they are not subject to provisions with respect to disclosure of tax information, even where crimes have been committed under Liechtenstein law. The U.S. treaty with Switzerland, moreover, provides that the tax exemption applies "only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to the benefits of this or any other Convention which provides exemption from these taxes." The proof required to overcome this limitation — of whether the premiums are reinsured and, if so, whether the reinsurer is entitled to the exemption — could possibly defeat the privacy aspects of the policy, assuming the insurance companies would be willing to provide the information.

The Private Insurance Portfolio qualifies as a life insurance policy for U.S. income tax purposes:

- If it is based on a segregated investment account and the segregated account is adequately diversified, i.e.:
  - No more than 55% of the value of the total assets of the account is represented by any one investment;
  - No more than 70% of the value of the total assets of the account is represented by any two investments;
  - No more than 80% of the value of the total assets of the account is represented by any three investments; and
  - No more than 90% of the value of the total assets of the account is represented by any four investments. To make certain that the segregated accounts comply with this "diversification rule", the portfolio needs to be re-balanced at the end of the first policy year and on a quarterly calendar basis thereafter.
- If it satisfies Internal Revenue Code rules on death benefits. These ensure that the insurance protection meets certain minimum requirements from the inception of the policy.

- If it is not self-directed, i.e., the policyowner must be deemed to have surrendered ownership or control of the assets. The income from a Private Insurance Portfolio is tax-free if the owner is not managing the investments himself. Conversely, the insurance company is deemed to be the beneficial owner of the segregated account. You may designate an investment advisor to manage the account. The insurance company will then hire the designated advisor to manage the assets. Policyowners are permitted to choose investment categories, but they may not choose the actual investments. If they do, they are treated as the beneficial owners of the underlying assets, not the insurance company, and the income generated by those assets would be taxable.

## Asset Protection

Life insurance is one of the very few forms of investment that's often inherently protected from creditor claims. Private Insurance Portfolio's, in particular, lends itself to asset protection planning and for many individuals will be a principal motivation for the investment.

Properly structured and established in the right jurisdiction, Private Insurance Portfolio's enjoy legal protection from creditors. Interestingly, Liechtenstein's laws on the protection accorded life insurance policies and annuities is directly taken from the relevant Swiss laws. To summarize, where a person not residing in Switzerland or Liechtenstein (the "policyowner") purchases an insurance policy from a Swiss or Liechtenstein insurance company and designates his spouse or his descendants as beneficiaries of such insurance policy, or irrevocably designates any other third party as beneficiary (e.g., a legal entity such as a Trust), this insurance policy will be protected by law against any debt collection procedures instituted by the creditors of the policyowner and will also not be included in any Swiss or Liechtenstein bankruptcy procedure in this regard. Even where a foreign judgment or court order expressly decrees the seizure of such policy, or its inclusion in the estate in bankruptcy, such an insurance policy may not be seized in Switzerland or Liechtenstein or included in the estate in bankruptcy, except where it is considered a fraudulent conveyance.

In case of bankruptcy of the owner, protection is also guaranteed since the ownership is transferred to the beneficiaries automatically. Any instructions from the original policyowner which are forced upon him can no longer be acted upon; only his beneficiaries, as the new owners can give instructions to the insurance company.

The insurance company can only act upon orders of the owner if his actions are deemed not to have been made under duress. If there is any evidence that an order has been forced upon the owner, such as in the case where the owner revokes in writing the beneficiary designation prior to a bankruptcy declaration, the insurance company cannot follow the instructions so issued. In such a case, it is important that the beneficiaries inform the insurance company.

The asset protection a Private Insurance Portfolio enjoys under Swiss or Liechtenstein law is truly state-of-the-art.

## Portfolio Management

The Private Insurance Portfolio can be considered as a sophisticated holding structure through which the investor (through his/her adviser) can direct the insurance company to invest in a wide range of investment vehicles.

A Private Insurance Portfolio serves the overall portfolio for the investor's long-term needs. This long horizon establishes one of the Private Insurance Portfolio's greatest privileges: to focus on wealth-creating (high-return) investments.

A Private Insurance Portfolio, then, becomes the main repository for relatively high-return hedge funds, private equity, and venture capital. Without a Private Insurance Portfolio, the value of a portfolio of high-return investments would be dampened because of the extremely large tax exposure that typically results from a focus on long-term wealth creation.

This combination of a very long-term investment horizon with the Private Insurance Portfolio's extreme tax efficiency establishes a unique platform upon which to build the investor's wealth-protected portfolio.

Various government and private-sector studies have shown that approximately 70 percent of an affluent investor's portfolio is devoted to supporting his/her working and retirement lifestyle needs, and 30 percent of the portfolio represents assets that are not targeted for any specific purpose. This latter asset pool represents the bulk of the assets backing a family's trust and estate plan. Beyond that, the portion of an investor's individual investment portfolio that's invested in highly taxed instruments is a logical source of funding for a Private Insurance Portfolio. Moreover, as wealth increases, the greater this free-standing asset pool becomes relative to the total portfolio.

A Private Insurance Portfolio presents a simple question to wealth-protected investors: If such long-term assets are not backing any particular lifestyle need, why subject them to taxes as well as to potentially adverse situations?

A Private Insurance Portfolio provides affluent investor's with an investment solution that can change the course of productivity in an investor's portfolio, not only for the current generation but also multiple generations thereafter.

To maximize the Private Insurance Portfolio's productivity, the underlying portfolio must be constructed to take advantage of a Private Insurance Portfolio's unique structure. Using a Private Insurance Portfolio's long-term horizon to establish a portfolio of high-returning investments, the future wealth of individuals and families can be dramatically improved.

**Prohibited Investments** These considerations must be part of the process of funding the policy:

- Assets such as collectibles cannot be included in the Private Insurance Portfolio because of legal and regulatory limitations.
- Assets such as closely held or restricted stock under direct investor control are not permitted.
- Investments in limited partnerships cannot simply be converted to a Private Insurance Portfolio.

## Getting started with a Private Insurance Portfolio

Specifically, the investor closes a contract in his name with an insurance company, usually domiciled in Switzerland or Liechtenstein. The insurance company opens an account with a Private Bank selected by the investor, who in turn receives a policy from the insurance company. Legally, the investor is the client of the insurance company and the insurance company is a client of the bank. The investor chooses to have the bank or designated investment adviser manage the account. The policy value consists precisely of the value of the assets placed there by the insurance company on the investor's behalf and grows as managed. Legal entities and natural persons can be designated as beneficiaries. With certain insurance companies, the policyowner may be a legal entity. The person insured, however, must in all cases be a natural person.

A Private Insurance Portfolio provides the important benefits of an offshore account with a private bank: confidentiality and privacy, professional and individualized asset management, and personal attention. As an insurance investment, a Private Insurance Portfolio also provides the following substantial benefits:

**Separate and Simple Estate Planning Device** Although a legal entity such as an estate planning trust can be named as irrevocable beneficiary of the Private Insurance Portfolio, this type of investment is also well-suited for making distributions separate from the policyowner's estate. However, depending on his home jurisdiction, some compulsory portions for legal heirs may be reserved. Neither power-of-attorney, nor last will nor certificate of inheritance is required for payments to be made upon the owner's death. Beneficiaries get immediate access to the funds according to the payment method chosen by the policyowner.

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**Confidentiality and privacy** In addition to the confidentiality provided by a bank account in the name of the insurance company, a second layer of confidentiality is provided by insurance confidentiality. In certain jurisdictions insurance companies treat client information as would their banking counterparts. No information can be provided to any third party (natural person or legal entity). In Liechtenstein, for example, a separate insurance secrecy law protects the privacy of policyowners. This law subjects not only persons affiliated with or acting on behalf of insurance undertakings to professional secrecy but also representatives of public agencies.

With the introduction of U.S. withholding taxes on U.S. assets held in foreign accounts and with the tough reporting requirements for investments made through offshore trusts, offshore insurance vehicles, if correctly structured and from the right jurisdiction, can add strong privacy to your existing investments in a trust or a bank account.

**Trust compatibility** A Private Insurance Portfolio is not necessarily a structure to replace offshore trusts, rather it can be used to complement a trust and to strengthen its protection. For example, assigning investments to an offshore trust is much cheaper and easier if they are grouped together under one Private Insurance Portfolio. This greatly simplifies the tax treatment of the structure, and consequently, the reporting requirements, either through a reduction in the number of assets to be listed or through the fulfillment of the conditions for tax deferral. Assets held within a Private Insurance Portfolio are considered to be held by the insurance company. This allows an investor or a trust to hold assets privately also under the regulations on U.S. withholding taxes on U.S. assets held in foreign accounts.

**Insurance coverage** The estate's wealth is preserved through the death benefit. In effect, until the policy's cash value reaches the death benefit, the insurance company bears the entire downside risk of the portfolio's performance.

Depending on the investor's own needs and requirements for his heirs, additional insurance coverage can be provided in case of death. Coverage can also be adjusted during the term of the contract. This feature can be very important if a remaining spouse is forced to pay off a mortgage or if heirs need cash to buy out business partners.

**Flexibility** Apart from being able to choose the amount of insurance coverage, the policyowner can choose to receive an annuity as well as choose to pay several premiums or a single one. As the underlying investments can be freely selected from a global palette of investments not available to the general public, the policy owner or his investment advisor (the latter for tax deferral) can optimize performance through wide diversification or hedging strategies.

## Conclusion

Either in combination with offshore or domestic planning structures or stand-alone, a Private Insurance Portfolio is a useful and cost-effective tool to upgrade an existing portfolio of investments. A portfolio's features can be added or improved with regard to asset protection, confidentiality, reporting burden, insurance coverage, and flexibility, reducing costs and taxes, including estate taxes as wealth passes from one generation to another.

Whether you are concerned with confiscatory taxes or the threat of litigation or are looking to diversify assets globally, with the Private Insurance Portfolio, wealthy individuals can address those concerns as well as have access to leading investment managers and to global investment opportunities otherwise not available to the public.