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THE WILL & THE WAY

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The Chair's Comments

As I write this soon after the New Year, and reflect on the problems and blessings that face us all from time to time, I come to the conclusion that we are fortunate in many ways.



E. William Kratt

As a nation, we are able to discuss issues in open forums. A small percentage of our population actively participates in peacefully ousting our country's head of state every four or eight years, while the rest witness that event without real disturbance or protest. Whether or not we agree with the result, we know that in another four years the opportunity will come to repeat the process, again without riot. Any disputes are taken to the courts. While there may be disagreement about the outcome, there is respect for the final judgment and the institution behind it. That is the essence of the "rule of law." We need only look at other parts of the world to appreciate the benefits of that process.

As a profession, we are in positions of leadership in all levels of government and community. We have a unique ability to impact the lives of our clients as well as the

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The Good, The Bad and The Ugly

Evolution of the Law Affecting End-of-Life Planning

BY GRAHAM D. HOLDING, CHRISTY EVE REID AND SUSAN I. MCCRORY

Over the last 30 years there have been significant changes to end-of-life planning. The changes were initiated as a result of "ugly" scenes played out on national television when grieving families were forced to sue health care providers in order to withdraw life-support systems from family members whose medical conditions would never improve. As a result of these lawsuits, Health Care Power of Attorney and Declaration of a Desire for a Natural Death ("Living Will") statutes were enacted that recognized an individual's right to control medical decisions, even when the individual lacked the ability to make or communicate those decisions.

In 2007 substantial changes were made in North Carolina's statutory Health Care Power of Attorney form as well as the statutory Living Will form. Although many improvements were made in North Carolina's statutory forms, for the reasons expressed below we have decided to recommend that, in lieu of the new statutory forms, our clients execute an alternative form that we have drafted combining the health care power of attorney and living will provisions. This alternative combined form appears in the 2007 supplement to the *BB&T Estate Planning Forms Manual* and as a .PDF document on the Robinson Bradshaw & Hinson Web site, www.rbh.com, that can be downloaded from the MenuForms page .

Historical Background

Historically, the presumption in the law favored the continuance of life under all circumstances. However, a movement to change the law and grant individuals the right to decide end-of-life medical treatment gained momentum in response to the legal challenges brought by fami-

ly members after the tragic accidents of two young women—Karen Ann Quinlan and Nancy Cruzan.

Beginning in 1975, when Karen Ann Quinlan suffered irreversible brain damage following complications from mixing alcohol and valium at a party, the movement to extend the common law right of an individual to refuse medical treatment in non-emergency situations to the right of an individual to elect to die a natural death without the intervention of life-prolonging measures began to gain national acceptance. In 1976, after Karen Ann Quinlan's parents secured the New Jersey Supreme Court's permission to disconnect their daughter from life support systems (*In re Quinlan*, 70 N.J. 10, 355A. 2d 647, cert. denied *sub nom.*, *Garger v. New Jersey*, 429 U.S. 92 (1976)), States began adopting Natural Death Acts. In 1978 North Carolina became one of the first States to pass a Right to A Natural Death Act, creating the first statutory "Living Will" form in North Carolina codified in Article 23 of Chapter 90.

Fifteen years later in 1990 the issue of end-of-life treatment was addressed by the United States Supreme Court in the case involving Nancy Cruzan, who suffered irreversible brain damage as a result of an automobile accident in January 1983. Unlike Karen Ann Quinlan, Cruzan was able to breath on her own but needed a feeding tube to receive the necessary nutrition and hydration to sustain her life. When the hospital refused to remove the feeding tube, her parents sued. The State of Missouri appealed the local probate court's order allowing the parents to remove the tube, and the Missouri Supreme Court, while

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Capturing Insurance Capacity

The Value of Owning All the Life Insurance You Can Get

By KENNETH R. SAMUELSON AND BRANDON W. DAVIS

The Background

Fundamentally, the purchaser of life insurance uses currently available, hard earned money to provide an insurance benefit for, well, somebody other than himself. On top of that, purchasing life insurance can be a mysterious process fraught with negative emotions.

The fact is most people want to buy as little life insurance as possible.

But times are changing. About five years ago, hedge funds and institutional investors showed up. They began investing heavily in mortality-based products by way of the premium financing and life settlement businesses. These professional buyers started acquiring life insurance benefits by the billions and based their decisions only on the statistics, primarily life expectancy and rates of return.

These institutional buyers make the life insurance companies nervous, because the professional money figured out that life insurance can be a valuable risk-adjusted asset to hold in a portfolio. A difference of opinion exists in the marketplace, an inefficiency if you will, between the insurance companies and institutional investors. Hedge funds are betting that life insurance is underpriced, and insurance companies are concerned that they may be right.

The Lesson

If life insurance is good enough to command Wall Street's attention and money, it may be good enough for Main Street's attention and money too. Clients may need to reassess the traditional "buy as little as possible" attitude toward life insurance.

The Question

How much life insurance can a client qualify for? Said more artfully, "What is my client's insurance capacity?" In true consultant fashion we would, of course, answer with "it depends." Assuming a client over age 70 in good health, the approximate amount would be: one times net worth up to a maximum of about \$125 million.

The Method for Systematic Evaluation of Insurance Capacity: ICE

The discussion about insurance capacity can be broken down into three components (complete with its own convenient, easy-to-remember acronym).

I: In-force coverage. This represents the insurance that is already in place. If the policy is more than five years old, it is very likely that it can be made more efficient through re-evaluation of the client's medical circumstances and comparison to new policies available in the market. A lot has changed, and many clients have reaped the benefit of this re-evaluation process. The reality is that old

“If life insurance is good enough to command Wall Street’s attention and money, it may be good enough for Main Street’s attention and money too.”

policies are built on old assumptions and are likely out of step with today's insurance pricing models. This is an area of large potential financial gain for clients. For additional commentary on this aspect, we refer you to our article on the importance of policy evaluation in the March 2007 issue of *The Will & The Way*.

C: Calculated need. This represents any additional insurance the client needs to complete or complement the current estate plan. Generally the client is willing to devote personal capital to accomplish such goals. Life insurance can address a specific need or create a desired financial result at death. For example, it can fund an estate tax liability, fund a buy-sell agreement or deliver a specific benefit to charity. It is important to evaluate these needs and place this coverage before tackling the third component, excess capacity.

E: Excess capacity. This represents any untapped insurance capacity that the client does not currently want for estate planning or

business purposes. Because life insurance has inherent value as a non-correlated asset class, the client may wish to put a policy in "inventory" for later use.

The big question looming in the client's mind: "Even if I see the benefit of owning my excess capacity, where is the money going to come from to buy it? I don't want to spend all of my liquid assets buying life insurance, no matter how good it is."

Capturing Excess Capacity

Currently, clients have two primary alternatives for harvesting the value of excess insurability: (1) own it themselves or (2) capitalize it by utilizing someone else's money to finance the acquisition of it. Because this asset has inherent value, we are proponents of having the family fund and control the asset. We will also address alternatives for capitalizing excess capacity with outside, third-party money. Chances are good that someone has approached or will approach your clients about this very topic.

Owning Excess Insurance Capacity

If Wall Street and foreign banks find this asset class valuable, perhaps clients should find value in it too and own it themselves. Why let others reap the benefit when the client's family could do the same? Just like a company keeps a supply of products in a warehouse, we often call this strategy "warehousing" insurance capacity. A couple of rational alternatives exist for clients wishing to warehouse insurance capacity for later use.

Good old-fashioned Term Insurance.

We are always looking for a reason to buy the cheap stuff. Well, here it is. Buy a term policy. The key: buy a policy from a high-quality provider that is "convertible" into a wide selection of permanent policies. At older ages, health can change in an instant; and once that happens, a term policy can have substantial value to the family.

It can also have substantial value in the life settlement market, an emerging and rapidly growing secondary market for unwanted life insurance policies. Under appropriate cir-

cumstances, selling a policy in the life settlement market can extract significant value from an existing life insurance policy—especially a term policy.

Please note that we do not advise clients to purchase life insurance with the *intention* of selling it. Frankly, it is bad for the industry and contrary to the underlying principles of insurance. Increasingly, regulators are establishing rules to prevent this from happening. But we view it as our duty (and perhaps your duty) to advise clients that the settlement market exists. It may be a viable alternative for maximizing the value of an unwanted policy when appropriate.

So, in short, why buy a term policy? It is an inexpensive way to warehouse insurance and guarantee future insurability. In a worst-case scenario, the client cancels the policy and receives no return of premium. The client has paid a fair market value for the cost of life insurance in the meantime.

Permanent life insurance. There is no shortage of varieties of permanent policies. A few unique design considerations bear mentioning. First, a number of high quality insurance carriers offer "high early cash value" policies. If structured properly, a client pays premium and the policy is projected to retain cash value near, equal to or greater than the amount of premium paid. It is a simple and cost-effective way to maintain significant insurance flexibility.

Secondly, select carriers offer unique product features designed to maximize long-term returns within the policy. A thoughtful and creative policy structure can dramatically improve the overall estate plan.

Lastly, remember the life settlement market. Under the right circumstances, premiums may be recovered by selling the policy in the secondary market. We have seen examples of clients purchasing life insurance, using it for a particular need over a specified time frame, and selling it in the secondary market for value in excess of premiums paid - sometimes significantly in excess of premiums paid.

Capitalize Excess Insurance Capacity

Types of programs. Programs using third-party money fall into two categories: (1) fully disclosed and (2) non-fully disclosed, aka "stealth" transactions. Regarding the latter transactions, perhaps you have heard about the New York State Department of Insurance's recent outrage over Investor

Owned Life Insurance ("IOLI") or Stranger Owned Life Insurance ("STOLI"). Insurance commissioners and life insurance providers alike are cracking down on inappropriate use of life insurance as an investment tool for institutions and investors.

Transactions being completed without full disclosure are considered "stealth" transactions. That is, they are completed such that the insurance company does not know that an investor initiated the transaction with the possible intention of selling it in the secondary market for a substantial profit. The immediate concern in such transactions is "does the investor have an insurable interest in the party being insured?" Insurable interest is a cornerstone of the life insurance industry. Would the initiator of the policy suffer a financial loss at the death of the insured such that insurance on the life of the person would be necessary? In stealth transactions, typically the answer is "no."

On the other hand, there remain a number of legal, valuable and viable alternatives for converting the ability to buy life insurance into a valuable asset. Most involve a conservative, well thought-out plan to finance the life insurance with a third party. They also involve participation by the insured in the form of cash paid out-of-pocket and/or the posting of collateral. No more free lunches.

Short-Term programs. "Short-term" programs typically involve a relatively small amount of cash or collateral on the client's part. In return, the client receives life insurance coverage for two to five years with the bulk of premiums paid by a lender. At the end of the program's term, the client typically has the ability to either retain the policy by repaying a loan that has accrued or walk away from the transaction by paying off a pre-determined portion of the loan. Note: even if the client walks away, the lender reserves the right to keep the policy in-force or sell it in the secondary market, which permanently ties-up a portion of the client's overall insurance capacity.

Long-Term programs. "Long term" programs typically involve an agreement to finance the life insurance policy for the entire life of the insured. Again, the insured is required to contribute some cash out-of-pocket and/or post collateral for the loan that will be accrued.

In exchange for financing excess insurance capacity, the insured's beneficiaries, e.g. heirs or charity, receive a portion of the policy's death benefit. The share of the new policy

allocated to the insured's beneficiaries is typically 5% to 15%. For example, if a client uses \$10,000,000 of excess insurance capacity, the projected benefit to the insured's designated beneficiary typically would be between \$500,000 and \$1,500,000.

No free lunch. A significant "cost" of capitalizing insurability is the permanent use of the insured's overall insurance capacity. Traditionally, most people have not assigned value to their insurability. However, the loss of a person's ability to buy additional insurance can be a significant loss. Capitalizing insurability is not a "something for nothing" arrangement. If the person anticipates ever purchasing additional life insurance, he or she should not commit all of the excess insurability to such a program.

The Bottom Line

Wealthy clients are constantly being approached about purchasing financed life insurance and they will come to you for advice. The ICE model articulated above will help guide decisions about life insurance capacity in a systematic and productive way. The model takes into account three important components of insurance capacity: In-force coverage, the Calculated need and Excess capacity. ■

SAMUELSON AND DAVIS ARE PRINCIPALS AT THE MOREHEAD GROUP INC., A FINANCIAL SERVICES FIRM IN CHARLOTTE SPECIALIZING IN LIFE INSURANCE FOR HIGH NET WORTH INDIVIDUALS AND FAMILIES. THEY CAN BE REACHED VIA PHONE (704) 334-2700 OR EMAIL [KSAMUELSON@](mailto:KSAMUELSON@MOREHEADGROUP.COM) OR [BDAVIS@](mailto:BDAVIS@MOREHEADGROUP.COM) MOREHEADGROUP.COM.

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Editor
Janice L. Davies

Editorial Address
P.O. Box 3688
Cary, NC 27519

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Comments *from page 1*

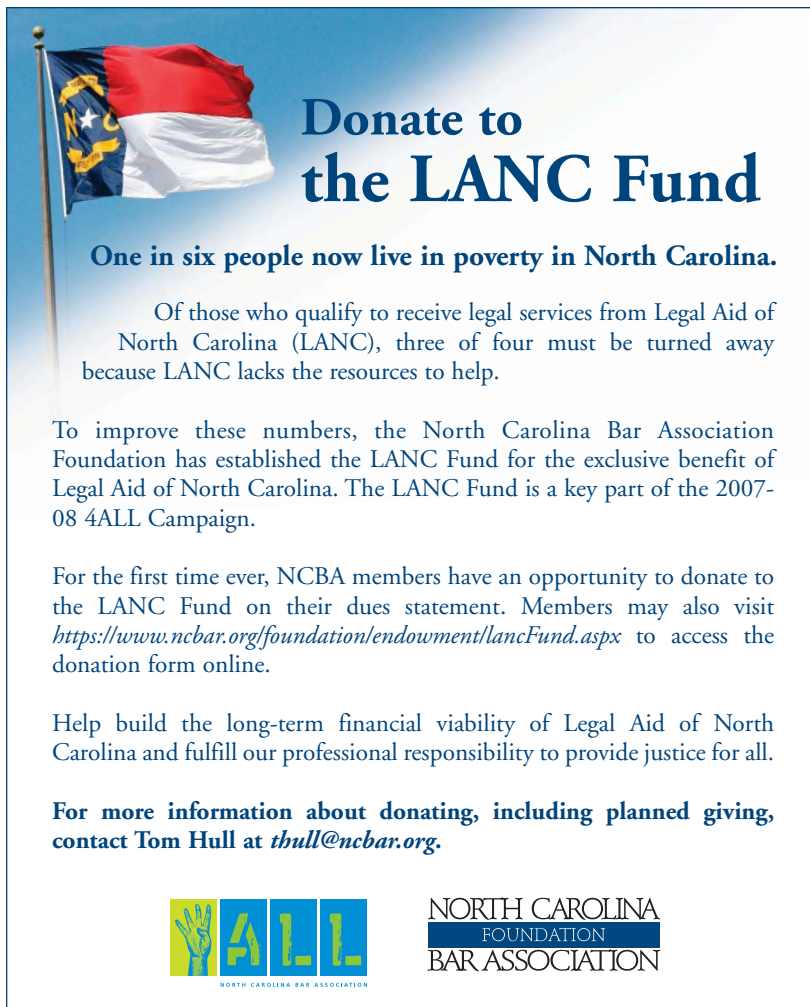
broader community by ensuring that the application of the law is proper, consistent and fair to all.

As a section, our membership continues to grow (we are one of the largest sections of the North Carolina Bar Association). Section members are involved in all aspects of the NCBA. In the past several months, former section council member and NCBA President Betty Quick received the Chief Justice's Professionalism Award; Jim Creamer and Knox Proctor were honored by the North Carolina Medical Society for successful efforts in updating the state's laws on advance health care directives; and Edward Griggs was selected by the NCBA's CLE Committee as its Volunteer of the Year. Proctor and Creamer accepted their award on behalf of the many members of the Elder Law, Health Law and Estate Planning & Fiduciary Law Sections who contributed to the drafting and adoption of the new law that went into effect on Oct. 1.

These recognitions are well-earned. The section is justifiably proud of those accomplishments, as well as those of other section members who have also done good works, whether recognized or not. I add my personal thanks, and encourage you to do the same.

As individuals, we work in one area of law that everyone needs (although that need is not always recognized in time). For some, there is continued satisfaction in the ability to make a living while doing something you enjoy.

We are indeed very fortunate. If you feel able to share that good fortune with others, please consider helping the NCBA and its sections with the many efforts that will be launched in the coming months as part of the 4ALL campaign. There will be many opportunities to participate personally, so keep an eye and ear out for more information in the weeks leading up to April 4. Your assistance is both needed and appreciated. ■



**Donate to
the LANC Fund**

One in six people now live in poverty in North Carolina.


Of those who qualify to receive legal services from Legal Aid of North Carolina (LANC), three of four must be turned away because LANC lacks the resources to help.

To improve these numbers, the North Carolina Bar Association Foundation has established the LANC Fund for the exclusive benefit of Legal Aid of North Carolina. The LANC Fund is a key part of the 2007-08 4ALL Campaign.

For the first time ever, NCBA members have an opportunity to donate to the LANC Fund on their dues statement. Members may also visit <https://www.ncbar.org/foundation/endowment/lancFund.aspx> to access the donation form online.

Help build the long-term financial viability of Legal Aid of North Carolina and fulfill our professional responsibility to provide justice for all.

For more information about donating, including planned giving, contact Tom Hull at thull@ncbar.org.



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