

Memo

To: Trustee
From: Andreas Stuermann
Date: 6/15/2018
Re: **Private Client Irrevocable Trust**

Dear Trustee –

The purpose of this memo to file is to summarize the recent policy exchange transaction.

Background & Problem

The Private Client 1996 ILIT, for which you serve as trustee, owned four loaned Northwestern Mutual whole life policies. Fixed loan interest rates of 8.00% and current dividend-crediting rates of 4.90% were eroding policy values and recent in-force illustrations from Northwestern Mutual indicated that if no further premiums were paid, policies would lapse in a few years and trigger taxable income of ca. \$1,400,000 to the policy owner. Your main goal was to avoid this taxable event and eliminate the need for further premium outlays.

Analysis & Solution

Over the summer we analyzed the existing policies vs. exchanging them tax-free under I.R.C. Section 1035 for a new Indexed Universal Life (IUL) policy. IUL provides upside return potential with downside protection. Cash value returns are tied to equity-based indexes with return floors and caps ranging from 0-11% on average. The analysis indicated that a new IUL policy could lower the risk of a taxable extent significantly because cash value returns can exceed loan interest rates. We also had to find a carrier that has the technology to exchange and administer loaned policies and make a competitive underwriting offer on a foreign national who is fond of vintage car racing. Pacific Life offered *preferred* risk rates and provided the best solution for the project at hand.

Projected Financial Results

The new Pacific Life policy was issued on November 20, 2017, funded with a single premium of \$1,508,665 (\$487,653 net of loan) from the existing Northwestern Mutual policies and has a minimum death benefit of \$2,489,229 (\$1,445,245 net of loan). The enclosed spreadsheet summarizes how the new policy will perform over time in different scenarios. If cash values earn 6.00% every year, no further premiums may be required because returns exceed loan interest rates (Scenarios 1 & 2). If cash values earn 6.00% every four years followed by 0.00% every fifth year, some additional premiums may be required in years 8-10 because returns are slightly lower than loan interest rates (Scenario 3). These additional premiums would be considerable less than a \$1,400,00 tax bill and could be funded by additional gifts or loans at that time.

Main benefits of the new Pacific Life policy include:

- 1) Better odds for positive arbitrage between cash value returns and loan interest rates,
- 2) Ability to tailor the policy's asset allocation to stock market and interest rate movements (current allocation is 25% International, 50% Indexed and 25% High Par per your instructions),
- 3) Flexibility to adjust the policy's cash value and loan accounts annually, and
- 4) Best in class product from a highly rated mutual carrier.

Ongoing Administration

We will review in-force illustrations with you every December to monitor how the moving parts within the policy are performing. The goals, as I understand them, are to maximize cash value returns, minimize loan interest costs and migrate policy values into fixed accounts once we have had sufficient positive arbitrage. These periodic annual reviews will tell us if and when we can do that.

Jeremy D. Cooke Irrevocable Trust
Summary of Projected Financial Results
 Executive Summary

Year	Age	Scenario 1				Scenario 2				Scenario 3			
		Annual Outlay	Account Value	Surrender Value	Insurance Benefit	Annual Outlay	Account Value	Surrender Value	Insurance Benefit	Annual Outlay	Account Value	Surrender Value	Insurance Benefit
1	2017	-	291,555	212,929	1,445,245	-	291,555	212,929	1,445,245	-	291,555	212,929	1,445,245
2	2018	-	269,388	230,074	1,393,045	-	269,388	230,074	1,393,045	-	269,388	230,074	1,393,045
3	2019	-	261,218	225,836	1,338,236	-	261,218	225,836	1,338,236	-	261,218	225,836	1,338,236
4	2020	-	262,062	230,612	1,280,687	-	262,062	230,612	1,280,687	-	262,062	230,612	1,280,687
5	2021	-	274,150	246,630	1,220,260	-	252,943	225,423	1,253,494	-	134,448	106,929	1,220,260
6	2022	-	290,991	267,402	1,179,715	-	248,068	224,479	1,225,690	-	141,715	118,126	1,156,811
7	2023	-	313,181	293,524	1,191,970	-	244,361	224,703	1,197,261	-	153,313	133,655	1,090,190
8	2024	-	340,847	325,120	1,210,912	-	241,660	225,933	1,168,191	(34,203)	204,014	188,288	1,020,238
9	2025	-	373,715	365,853	1,235,479	-	239,745	231,883	1,138,468	(34,203)	262,391	254,529	1,074,089
10	2026	-	407,894	407,894	1,259,775	-	235,226	235,226	1,108,076	(34,203)	139,818	139,818	879,060
11	2027	-	460,724	460,724	1,307,842	-	246,469	246,469	1,077,000	-	176,383	176,383	912,051
12	2028	-	522,575	522,575	1,365,398	-	258,262	258,262	1,045,225	-	221,580	221,580	954,494
13	2029	-	593,567	593,567	1,432,468	-	270,417	270,417	1,012,735	-	274,470	274,470	1,004,925
14	2030	-	674,720	674,720	1,510,346	-	283,061	283,061	979,514	-	335,882	335,882	1,064,393
15	2031	-	766,850	766,850	1,599,656	-	295,997	295,997	945,545	-	163,643	163,643	819,180
16	2032	-	859,880	859,880	1,700,302	-	308,225	308,225	910,812	-	227,305	227,305	882,212
17	2033	-	986,318	986,318	1,814,670	-	321,639	321,639	875,298	-	300,888	300,888	955,353
18	2034	-	1,117,517	1,117,517	1,943,855	-	336,577	336,577	838,984	-	385,368	385,368	1,039,357
19	2035	-	1,265,476	1,265,476	2,090,015	-	353,422	353,422	801,854	-	481,730	481,730	1,135,215
20	2036	-	1,431,293	1,431,293	2,254,437	-	372,872	372,872	797,293	-	271,308	271,308	859,814
LE 21	2037	-	1,617,315	1,617,315	2,439,904	-	395,627	395,627	800,571	-	372,788	372,788	962,038
22	2038	-	1,824,710	1,824,710	2,647,682	-	420,952	420,952	807,783	-	488,431	488,431	1,079,061
23	2039	-	2,056,248	2,056,248	2,880,765	-	447,869	447,869	817,729	-	619,497	619,497	1,212,196
24	2040	-	2,314,223	2,314,223	3,141,367	-	476,869	476,869	830,275	-	767,952	767,952	1,363,430
25	2041	-	2,600,184	2,600,184	3,430,621	-	506,070	506,070	844,868	-	506,110	506,110	1,045,118
26	2042	-	2,916,865	2,916,865	3,748,638	-	537,176	537,176	860,613	-	660,375	660,375	1,201,255
27	2043	-	3,268,777	3,268,777	4,098,477	-	569,893	569,893	877,252	-	834,714	834,714	1,375,117
28	2044	-	3,659,567	3,659,567	4,481,412	-	604,917	604,917	894,884	-	1,031,870	1,031,870	1,567,955
29	2045	-	4,097,570	4,097,570	4,902,288	-	643,600	643,600	913,945	-	1,256,983	1,256,983	1,782,600
30	2046	-	4,588,377	4,588,377	5,359,953	-	686,812	686,812	933,607	-	931,857	931,857	1,385,920
31	2047	-	5,072,891	5,072,891	5,775,186	-	731,935	731,935	947,038	-	1,138,346	1,138,346	1,552,354
32	2048	-	5,554,328	5,554,328	6,131,844	-	781,214	781,214	951,496	-	1,338,284	1,338,284	1,679,225
33	2049	-	6,092,503	6,092,503	6,457,534	-	843,734	843,734	947,560	-	1,568,141	1,568,141	1,783,942

Notes

1. The new Pacific Life policy was funded with a gross premium of \$1,508,655 (\$487,653 net of loan) from existing Northwestern Mutual policy values.
2. The new Pacific Life policy was issued with a death benefit of \$2,489,229 (\$1,445,245 net of loan) which is the minimum amount to qualify as life insurance.
3. Projections for scenario one assume static cash value returns of 6.00% every year and static variable loan interest of 5.00% every year.
4. Projections for scenario two assume static cash value returns of 6.00% every year, variable loan interest of 5.00% years 2-4 and fixed loan interest of 2.25% years 5+.
5. Projections for scenario three assume varying cash value returns of 6.00% every four years followed by 0.00% every fifth year and static variable loan interest of 5.00% every year.
6. The actuarial life expectancy of a 67 year-old male is 21 years (using 2015 VBT mortality tables).