Corporate Owned Life Insurance for Insurance Companies:

A Tax and Capital Efficient "Wrapper" for Alternative Assets

Separate account private placement life insurance corporate owned life insurance ("COLI") is an effective wrap for higher risk charge general account investments offering substantial enhancement to after-tax yields and materially lower capital charges.

COLI is a life insurance product which can be purchased by insurance companies on a group of eligible key employees. The company pays the premium and is the owner and beneficiary of the insurance policies. In general companies are permitted to insure their top 35% highest income employees that consent to being insured.

COLI is an institutionally priced product designed to have an initial cash surrender value equal to premium and minimal drag from insurance charges (typically about 80bps). No medical underwriting is required for COLI; employees only need to complete a one page form with 3-5 questions.

There is a wide range of existing investment options available on COLI platforms including fixed income, equity, hedge fund and private equity strategies. In addition, the purchaser can cause a new fund or managed account to be created and managed by an elected third party investment manager of their choosing.

COLI is available in the form of fixed crediting rate product and separate account private placement life insurance ("PPLI"). Historically, insurance companies have purchased fixed credit COLI; however in the current low rate environment such products are generally unavailable or unattractive.

COLI, in the form of separate account PPLI, provides two important benefits for insurer purchasers: tax and capital.

The gains on underlying investments are permanently tax deferred and the death benefits are received tax free. This represents significant yield enhancement for insurers, which is particularly valuable in today's low rate environment. Below is a hypothetical comparison of owning a taxable investment versus owning the same investment inside COLI:

	Taxable Investment ($M)	COLI ($M)	Annual Enhancement to Income and Surplus ($M)
Investment return @ 7%	$ 7.00	$ 7.00	
Taxes due @ 35%	2.45	-	
After-tax return	4.55	7.00	
Insurance expense	-	0.80	
Net Income	**$ 4.55**	**$ 6.20**	**$ 1.65**

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Please contact us for more information.
We would be happy to provide a more detailed presentation tailored to the specifics of your company and describing your potential benefits.

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In addition to being tax efficient, insurers can obtain a capital benefit from owning COLI. Since COLI is booked as an "other than invested asset" for statutory accounting, it is not considered an invested asset in regulatory and rating agency capital models. The capital charge on COLI is a modest credit risk charge based on the counterparty risk associated with the carrier writing the COLI. For high risk charge asset classes (e.g. hedge funds, private equity, high yield fixed income, etc.) the capital charges for owning the asset in a COLI contract can be significantly lower than owning the same asset directly.

Below is a hypothetical S&P capital charge comparison of a life insurer investing $100 million directly versus through COLI:

	Own Directly	Own through COLI	Enhancement ($M)
$25M High Yield Debt	$ 10.31	$ 0.38	
$25M Common Stock	9.50	0.38	
$25M Hedge Fund	9.50	0.38	
$25M Private Equity	9.50	0.38	
Total S&P Capital Required (A-level)	**$ 38.81**	**$ 1.50**	**$ (37.31)**

Similar capital benefits occur under the AMBest and RBC capital models. Actual charges vary depending on whether the purchaser is a life insurer, a property & casualty insurer or a health insurer. There is zero charge for COLI under RBC for life insurers.

For statutory accounting, COLI is booked as an "other than invested asset" and held at its cash surrender value. Increases (decreases) to the cash surrender flow through "other income". Similarly, for GAAP accounting, COLI is booked as an "other asset" and increases (decreases) to cash surrender value flow through "other income".

Insurers should consider separate account PPLI COLI as an investment platform for owning their higher risk charge assets which include: equities, hedge funds, private equity, below investment grade fixed income assets, and other alternatives. In some cases COLI may make available asset classes which were previously ruled out due to tax, capital, and regulatory (non-admitted) considerations.

Each insurer's specific tax and capital benefit will depend on their particular tax and capital position. The potential size of the program will depend on the number of eligible employees. Montshire Advisors can assist you in considering your specific benefits. Montshire can advise you on important considerations regarding a COLI program such as: contract design, alternative minimum tax and modified endowment contract tax considerations, optimization and structuring of policies, determination of eligible employees and the design of an effective communication program, evaluating and determining optimal investment choices for your COLI program.

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