INSURANCE COMPANY-OWNED LIFE INSURANCE

> When it comes to investments that help improve earnings and optimize risk-adjusted returns, the options are few.
>
> *ICOLI enhances investment results and financial viability while achieving favorable risk-based capital treatment, tax efficiencies, and portfolio diversification.*

INTRODUCTION

Insurance company owned life insurance (ICOLI) is an attractive investment strategy utilized by life or property and casualty insurers to help offset a variety of employee benefit costs while providing favorable tax, accounting, and risk-based capital treatments.

While ICOLI is not required to finance a specific plan, it is purchased by the insurance company on the lives of a select group of key employees. The company is the owner and beneficiary of the policies, although some companies may include an executive benefit that shares a portion of the insurance proceeds with participants.

Cash value growth in the ICOLI policies are tax-deferred (tax-free if held until death), and the death benefits are tax-free.

Additional key benefits include reduced capital reserve requirements, a wide range of investment fund choices, and possible income statement advantages. Taken together, the tax savings for an insurance company with ICOLI can be significant.

Many attractive investment strategies with high return profiles may also come with costly barriers to entry for insurance companies, such as high capital reserve requirements or tax inefficiencies. When utilized inside an ICOLI structure, these same strategies reduce risk-based capital charges, enjoy tax-deferred growth, and deliver enhanced financial performance.

ICOLI BENEFITS

Favorable tax treatment

- Potential for higher investment yields due to tax-favored status
  - Cash value growth is tax-deferred
  - Protection of capital via tax-free death benefits
  - Does not create a tax-deferred liability

Investment flexibility

- Access to a wide array of investment strategies
  - Allocate to virtually any asset class
  - Inclusive of tax-inefficient assets and assets with high risk-based capital charges
  - Align long-term investment goals with stated mandates
  - Reallocate investments within ICOLI without incurring taxes

Favorable risk-based capital treatment

- Potential to reduce capital reserve requirements
  - NAIC RBC charge is 0% for life companies and 5% for property and casualty companies

Favorable accounting treatment

- Income runs through earnings
- Potentially favorable GAAP and Statutory accounting
  - GAAP (ASC 325)
    - Balance Sheet: ICOLI reported as "Other Asset"
    - Income Statement: ICOLI gains as "Other Income"
  - Statutory
    - Balance Sheet: ICOLI reported within "Aggregate write-ins other than invested assets"
    - Income Statement: ICOLI gains reported within "Aggregate write-ins for miscellaneous income"

Clear regulatory and tax guidelines

- ICOLI is an admitted asset
- COLI Best Practices Act provides simple, straightforward guidance
- IRS Revenue Procedure 2007-61 confirms insurance companies' eligibility for beneficial tax treatment

Advantage: ICOLI

Assets with typically high capital charges receive favorable capital treatment within ICOLI. The following chart illustrates this difference for both life and property and casualty companies using a hypothetical private equity investment.

	LIFE COMPANY – CAPITAL CHARGE			P&C COMPANY – CAPITAL CHARGE		
	REGULATORY RBC	S&P (A)	AM BEST	REGULATORY RBC	S&P (A)	AM BEST
Private Equity	23.7%	38.0%	36.0%	20.0%	26.4%	20.0%
Private Equity in ICOLI	0.0%	6.6%	0.8%	5.0%	6.6%	5.0%

HYPOTHETICAL INVESTMENT COMPARISON

The following chart illustrates how a hypothetical ICOLI purchase compares to a taxable investment. In this example, ICOLI provides a higher after-tax return, a notable improvement in investment earnings.

HYPOTHETICAL INVESTMENT COMPARISON		
	TAXABLE INVESTMENT	HYPOTHETICAL ICOLI
Yield (Net of All Management Fees and Transaction Costs)	7.00%	7.0%
Less: Insurance Expense	0.00	.50
Pretax Return	7.00	6.50
Less: 21% Assumed Tax Rate	1.47	0.00
After-tax Return	**5.53**	**6.50**
Tax Equivalent Return	**7.00%**	**8.23%**

SUMMARY

ICOLI is a tax- and capital-efficient investment vehicle that insurance companies can employ to finance aggregate employee benefit liabilities, including healthcare and general welfare programs, as well as executive benefit plans. Companies typically purchase ICOLI for the opportunities and advantages it presents in the areas of investment flexibility and favorable tax, accounting, and risk-based capital treatments.

For companies looking to invest in strategies that optimize risk-based returns, improve financial strength, and help them manage bottom-line impact, an ICOLI acquisition can meet those objectives.

Once an insurance company is ready for an ICOLI transaction, understanding how to structure the program to best align with corporate objectives is the next step. Identifying a strong consultative partner to navigate this and other complex aspects of an ICOLI undertaking is a crucial part of conducting due diligence during the pre-purchase process.

A provider that specializes in the design, implementation, and ongoing administration of these alternative investments can help ensure the arrangement is tailored to realize successful outcomes in the most cost-effective and tax-efficient manner, while complying with insurance regulatory requirements.

Comprehensive services would include product evaluations and recommendations, participant enrollment, ongoing policy administration, reporting, and annual reviews. Selecting a firm with proven expertise can significantly reduce the insurance company's administrative burden and maximize the benefits of an ICOLI strategy.

For more information, please email M Executive Benefits at **questions@mben.com**.

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