ADVANCED PLANNING

Exchanging your policy

"Mirrored Loans"–Your Options and Important Considerations

THERE MAY BE BENEFITS TO EXCHANGING YOUR POLICY

You may have purchased a permanent life insurance policy several years ago. It's accumulated significant cash value. But, compared with the innovations found in many of today's life insurance products, your policy may now be underperforming or no longer economical.

What's more, you've taken loans from the policy to pay ongoing premiums and to fund cash needs. Those loans, combined with higher mortality costs and high loan interest charges, may have subjected the policy to a potential unintended lapse.

If this scenario fits your current life insurance policy, you have three courses of action to choose from:

OPTIONS TO ADDRESS THE LOAN ARE	
Do Nothing	The policy may lapse and taxes will be due if there is gain in the policy.
Make Changes to the Existing Policy	Pay down or repay the loan using policy values or out-of-pocket funds. This may require a change to the annual outlay, a reduction to the policy death benefit, or both.
Complete a 1035 Exchange to a New Policy and Mirror the Loan	A 1035 exchange is a provision in the tax code. In general, it allows you, as a policyholder, to transfer funds from a life insurance policy to a new policy, without having to pay taxes at the time of transfer. When executed and designed properly, a 1035 exchange to a newer policy where the loan is mirrored may provide higher death benefit coverage and lower loan interest charges. The loan on the new policy can then be repaid out of pocket. Alternatively, in year two or later, you can request a withdrawal, paying down the loan by using the policy's available cash value. It is important to know that a withdrawal may incur surrender charges, may be subject to taxation, and the death benefit will be reduced. In addition, ongoing premium payments may be needed.

What is a mirrored loan?

A 1035 exchange where a loan on an old policy will be transferred to a new policy. This may provide higher or longer death benefit coverage.

Continued on next page.

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IF YOUR CURRENT POLICY HAS AN OUTSTANDING LOAN

When your current life insurance policy includes a loan, you need to be particularly careful when making the decision to complete a 1035 exchange.[1] You should first look to see if it makes sense to make changes to your existing policy. That may mean paying down or repaying the loan using policy values or out-of-pocket funds. This may require a change to the annual outlay, a reduction to the policy death benefit, or both. If it is determined that it makes sense to replace the existing policy and complete a 1035 exchange, one very important factor to consider is that the loan, in whole or in part, may be taxable at the time of a 1035 exchange if it is not carried over into the new policy as part of the exchange. You will receive a 1099 tax form in the year that the 1035 exchange is made.

If your long-term strategy is to carry over the loan and pay it off in a subsequent year, keep these additional tax considerations top of mind:

- Even when the loan is carried over into the new policy as part of the exchange, if the loan is not subsequently repaid, it is possible that the loan will be subject to taxation at some point in the future. In some cases, the loan on the new policy will be required to be repaid as early as year two of the new policy's effective date, or shortly thereafter, to avoid lapse and taxation.
- For as long as the loan remains on the new policy, it will be necessary to monitor the performance of the policy, as well as the policy's loan interest rate charges, on an ongoing basis. This is to ensure that the loan does not cause the policy to lapse and result in a taxable event. Moreover, the policy's loan interest rate is subject to change and will be higher or lower than the original rate illustrated.
- When the repayment of the loan is delayed, it is possible that the underlying performance of the policy may be negatively affected.
- Initiating a withdrawal may trigger surrender charges and reduce the policy's death benefit. A withdrawal may generate taxable income.

It's also important to know that a policy illustration is hypothetical and not indicative of the future performance of the policy. Illustrated values and assumptions are not guaranteed. Actual policy results may be higher or lower than as illustrated. 1035 exchanges may be subjected to policy surrender charges.

THE POTENTIAL BENEFITS TO EXCHANGING YOUR LIFE INSURANCE POLICY

- Many of today's new types of life insurance policies that weren't available even a few years ago may offer more flexibility or be more suitable for your current needs.
- As your family, business, and financial status have changed, your objectives for your life insurance may have changed too. To meet those objectives, it may be necessary to make changes to your current coverage.
- In some cases, a new policy may solve your need for life insurance in a more cost-effective and efficient way.

MAINTAINING YOUR NEW POLICY

If you and a financial professional have determined that a new life insurance policy will better meet your protection needs, you and your financial professional will work to set it up and execute the 1035 exchange. The policy will transfer with the loan intact and your new policy will begin. The new policy should have the potential to accumulate cash value. As early as year two, you may be able to withdraw the cash value to pay down the loan, although doing so may trigger surrender charges and will decrease the policy's death benefit.

Changes and repayments are not automatic. It's important to monitor your policy and the loan throughout the duration of the policy. Your financial professional can work with you to determine the options you have for repaying the loan from either your policy's cash value or other assets.

[1] A reportable policy sale may occur upon a transfer of ownership on the policy or upon a Section 1035 exchange, where there is no substantial relationship between you and the insured as defined by the relevant Treasury Regulations. Please consult a tax advisor before exchanging your policy.

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A FINANCIAL PROFESSIONAL CAN HELP

A financial professional can review your current policy and anything that may have changed in your life since you purchased it. If your policy is no longer meeting your needs, a financial professional can help you explore policies that may provide more appropriate protection and features, and run a customized illustration to show you how a new policy could work. If a 1035 exchange makes sense for your circumstances, he or she can guide you through the process.

AVOID TAXES ON YOUR POLICY LOAN

Remember, you have the option to repay the loan from either your policy's cash value or other assets. The loan on the new policy should be repaid at some point after year two to avoid lapse and taxation. If you decide to repay the loan using the policy's cash value, it will be necessary for you to call customer service at 1-800-782-5356, Option 0 to request a Customer Withdrawal Form. When completing the form, it's essential to elect the "Withdrawal to go toward policy loan repayment" option. Otherwise, the withdrawal will be sent to you in the mail and you will be required to return it and request that it be applied to the repayment of your policy loan. Please take into consideration that initiating a withdrawal may trigger surrender charges, will reduce the policy's death benefit, and may result in taxation.

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