ADVANCED PLANNING

CLIENT STRATEGIES

1035 Exchanges and Mirrored Loans

Help relieve a client's policy loan burden

When a client's policy has loans, a 1035 exchange to a new policy may provide a needed death benefit at a lower cost.

It may also offer clients living benefits to satisfy additional needs.

CLIENT CONCERN

During a policy review, you come across an existing policy that a client purchased many years ago. It has accumulated significant cash value. However, you see that loans have been taken from the policy to pay for the premiums and/or to fund cash withdrawals. Those loans, combined with higher mortality costs and high loan interest charges, have subjected the policy to a potential unintended lapse.

If this scenario fits the client's current life insurance policy, the client has three courses of action to choose from:

THE CLIENT'S OPTIONS TO ADDRESS THE LOANS 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	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, the client 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.

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CLIENT STRATEGY: MEET SCOTT

Scott Stevens, age 50, has a whole life policy purchased over 23 years ago. He's taken loans from the policy to make his premium payments. The loan principal and interest charges have combined, resulting in a negative effect on the death benefit.

Scott needs the death benefit coverage, but can't continue to pay premiums or address the loan. He has a daughter in college and is also focused on funding his retirement plan at work. To address these concerns, Scott's financial professional determines Scott has the appropriate risk tolerance for variable investing and recommends he complete a 1035 exchange of his policy to Prudential's VUL Protector®, which would include the existing loan. Because the new policy is more cost-efficient, the loan on the new policy is assumed to be repaid using the new policy's cash values in year two. Take a look:

19% DEATH BENEFIT INCREASE

Current Policy Information	Element	Proposed Policy Design
$1,000,000	Net Death Benefit	$1,188,763
N/A	1035 Exchange Amount	$375,000
$295,000	Net Cash Surrender Value	$206,287
$80,000	Loan	$81,600
$0	Annual Premium Outlay	$0
$175,000	Cost Basis	$175,000
6%	Loan Interest Charge	2%

Proposed policy assumptions: VUL Protector, male, age 50, non-smoker plus, at an illustrated rate of 6.5% to age 121, Death Benefit option B for the first 7 years, and then Death Benefit option A thereafter. This hypothetical example is for illustrative purposes only. Actual results will vary.

ACTION REQUIRED: Loan repayment is not automatic. The client must call Prudential Customer Service (800-782-5356, Option 0) to request a withdrawal in a subsequent year (as early as year two) to repay the loan using the new policy's cash value. Initiating a withdrawal will trigger surrender charges and will reduce the policy's death benefit.

The above hypothetical example assumes non-guaranteed rates and current charges. It is necessary to assess how the policy performs under 0% return assumptions and maximum insurance charges; the policy lapses in year 28.

BENEFITS

In general, by exchanging an old life insurance policy with a loan for a new policy that mirrors the loan, the following benefits may be achieved:

- The new policy may provide a higher death benefit than the old policy.
- The new policy may offer an enhanced no-lapse guarantee to age 74 regardless of market performance.[1]
- The 1035 exchange allows the client to avoid taxation associated with the loan when the loan is mirrored.
- The loan interest charges and mortality and expense charges on the new policy can be significantly less, thereby preserving more of the contract's values over the long term.
- Depending on how much cash can be transferred from the old policy, net of fees and policy loan, and depending on new policy performance, policy values may be used to pay policy charges. In all cases, the policy should be carefully monitored and additional premiums should be paid if necessary to continue the policy.
- New riders, such as one that can accelerate the death benefit in the event of a chronic illness, may be added to the new policy in the exchange.

[1] No-lapse guarantees are conditional guarantees that can keep the policy in effect, even if policy values are not sufficient to do so. These guarantees may not last as long as clients wish to keep their policies. Conditional no-lapse guarantees will not keep policies from lapsing due to excess policy loans.

PRUDENTIAL REQUIREMENTS

Prudential has established the following guidelines governing 1035 exchanges with mirrored loans to ensure suitability:

- The new policy must have a minimum net cash value of $25,000.
- The gross cash value, after transfer, must create enough immediate net surrender value to mirror the loan and place the new policy in force.
- All 1035 exchanges with mirrored loans require underwriting approval.
- The client must call Prudential Customer Service (800-782-5356, Option 0) to request a withdrawal in a subsequent year (as early as year two) to repay the loan using the new policy's cash value. Initiating a withdrawal may trigger surrender charges and reduce the policy's death benefit. A withdrawal may generate taxable income.

CONSIDERATIONS

1035 exchange of an existing policy with a mirrored loan is not for everyone.

- If the loan is not mirrored on the new policy in the 1035 exchange, the client may incur taxes.
- The long-term impact of the loan that is mirrored on the new policy must be considered.
- It will be necessary, in most cases, for the policyowner to repay the loan in year two or later. The cash value, if sufficient, may be used to repay the loan, or funds outside of the policy can be used to repay the loan. If the loan is not repaid, the policy performance must be reviewed on an ongoing basis to consider options that can help ensure against lapse. If the policy is owned by a trust, transfer taxes must be considered when repaying the loan.
- Policy loan repayment is not automatic. Please work with clients to monitor repayment as well as policy performance.
- In order for the loan to be repaid, the client must call Prudential Customer Service (800-782-5356, Option 0) to request a withdrawal to repay the loan using the new policy's cash value. Initiating a withdrawal is likely to trigger surrender charges and will reduce the policy's death benefit.
- 1035 exchanges may be subjected to policy surrender charges and may have tax consequences.

RELY ON PRUDENTIAL'S ADVANCED PLANNING PROFESSIONALS

Prudential's Advanced Planning team has the experience to help you successfully identify and complete a mirrored loan rescue opportunity. Questions? Call Advanced Planning at 800-800-2738, Option 4.

Where there is a reduction in benefits with an associated distribution on a non-MEC life insurance policy in the first 15 years, the recapture rules under Code Section 7702(f)(7) may be triggered. In those circumstances, the normal non-MEC tax rules do not apply and the cash distributed may be taxable to the extent of gain. Clients should consult an independent tax advisor prior to making changes to a policy.

VUL Protector is issued by Pruco Life Insurance Company in all states except New York, where it is issued by Pruco Life Insurance Company of New Jersey and offered through Pruco Securities, LLC (member SIPC). All are Prudential Financial companies located in Newark, NJ.

Clients should consider the investment objectives, risks, and charges and expenses carefully before investing in the contract, and/or underlying portfolios. The prospectus and, if available, the summary prospectus contain this information as well as other important information. A copy of the prospectus may be obtained from www.prudential.com. Clients should read the prospectus carefully before investing. It is possible to lose money by investing in securities.

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