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Why Do So Many Foreign Nationals Want U.S. Life Insurance?

Companies are increasingly creating formal programs in order to address the unique planning, structural and tax needs of these clients. Why?

Michael Gomez | Aug 31, 2021

The U.S. life insurance industry enjoys a number of advantages over other countries, making it increasingly attractive to non-U.S. citizens and residents, namely high death benefit capacity, comparatively low insurance costs, well-capitalized insurers, stable currency and a robust regulatory environment. This edge has led to more U.S.

life insurance companies creating formal foreign national programs in order to address the unique planning, structural and tax needs of these clients.

While foreign nationals turn to U.S. life insurance for a number of reasons, they generally do so related to five strategies:

1. Seeking large amounts of death benefit;
2. Addressing a U.S. estate tax liability;
3. Planning to immigrate to the U.S.;
4. Positioning as a desirable portfolio asset to balance against a variety of international holdings; and
5. Obtaining competitive premium financing terms.

Large Death Benefit

Without exception, death benefit capacity in other countries is either far less than in the U.S. and/or more costly. This is a function of both an insurer's financial restraints to pricing insurance as well as the price at which global reinsurers will sell death benefit capacity to life insurance companies. The balance sheets of U.S. insurance carriers permit attractive insurance pricing with reinsurers generally viewing the U.S. life insurance market as less risky than other markets and this is reflected in their cost of insurance.

Antonio Gastélum, a partner in the law firm MEG International Counsel PC, explains: "Life insurance products in Mexico can cost twice as much and offer a fraction of the total death benefit as U.S. policies. When a Mexican is seeking significant coverage, it makes sense to turn to the U.S. market, especially if domestic products cannot meet their needs."

As little as 20 years ago, foreign nationals mostly tried to avoid the U.S. life insurance market for fear they would become tied to the U.S. tax system or lose a degree of privacy to the U.S. government. "Given the international tax transparency

and financial reporting created by both FATCA and CRS where one's financial matters are known, there really isn't a hesitancy for foreign nationals to apply for and purchase U.S. life insurance," says Gastélum, who is licensed to practice law in Texas and Mexico. "In fact, the Mexicans who are the most comfortable buying large life policies in the U.S. are those who are very familiar with the country. They are folks who are already doing business in the U.S., have homes and other property here and have family living here."

Addressing a U.S. Estate Tax Liability

By obtaining property in the U.S., foreign nationals create a U.S. estate. U.S.-situated assets that are subject to estate tax include, for example:

- Real estate located in the U.S.;
- Tangible personal property (excluding some art); and
- Stock of corporations organized in or under U.S. law, even if the nonresident held the certificates abroad or registered the certificates in the name of a nominee.

At the death of a foreign national with U.S. estate tax exposure, if the fair market value at death of the decedent's U.S.-situated assets exceeds $60,000, an executor for a nonresident and who is not a citizen of the U.S. must file an estate tax return, Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return.

"Depending on if a tax treaty exists and what provisions the treaty has to offset U.S. taxes with those in a foreign national's home country, there could very well be transfer taxes due to the U.S. Treasury on the value of the foreign national's U.S. assets subject to U.S. estate tax in excess of the $60,000 exclusion," says Michael Fontanini, vice president, advanced planning and design with Lion Street, a national network of independent life insurance and wealth management advisors headquartered in Austin, Texas. "Using the income tax-free death benefit proceeds

from a U.S. life insurance policy to pay these taxes is a common and efficient technique."

Fontanini often sees foreign national clients owning their U.S. policies in U.S. trusts or LLCs. "The trust or LLC is usually also the beneficiary, and these structures have provisions on how to direct the death benefit. Though, there are jurisdictions which require their citizens who are buying foreign policies to do so in their own name for transparency."

Fontanini provided a 2019 example of the need for coverage to meet a future U.S. estate tax. "Mr. Chu," age 60, is a citizen and resident of China who has resided in the U.S. for up to four months a year for the past decade. Over this time, Chu had accumulated substantial business and real estate holdings in the U.S. worth around $200 million and needed $80 million in coverage to pay estate taxes at his death.

The $80 million in death benefit was obtained through a process called "staging," where a number of policies from various U.S. life insurance companies, including those ceding to different reinsurance companies, were applied for and issued. Chu purchased the policies inside of an irrevocable trust established in Delaware, which also would serve as the beneficiary of the policies. The trust would then use the death benefit proceeds to pay the future estate tax.

Preimmigration Planning

When foreign nationals plan to immigrate to the U.S., much of their structuring addresses the reduction of a future U.S. estate. This is largely accomplished by establishing an irrevocable trust and moving assets into the trust and out of the estate created when the foreign national obtains either U.S. citizenship or a Green Card. "Using funds in a foreign grantor trust to buy a U.S. life insurance policy accomplishes a number of goals," says Gal N. Kaufman, a partner at the law firm FisherBroyles and co-chair of the firm's private client services group. "First, life insurance creates tax-efficiency for the premiums used and growing inside the

policy. Then, for foreign grantor trusts with U.S. beneficiaries, a policy cuts off undistributed net income ("UNI"), which is harshly taxed."

Kaufman points out that if a foreign national chooses a private placement life insurance policy, premiums can be paid in-kind to the policy without triggering U.S. taxation due to the sale of the assets to the policy. "Since the client isn't a U.S. taxpayer, yet, they often have more freedom with the ability to fund a PPLI policy with existing investments instead of just cash. Once the client becomes a U.S. taxpayer, however, an in-kind premium payment will be treated as a sale and potentially trigger taxation on any gain."

The large death benefit capacity of U.S. policies often fits with preimmigration planning due to the sizable premiums regularly paid. Capacity restraints for policies in other countries would substantially restrict the amount of premiums contributed where policies will still need to meet the U.S. definition of life insurance and therefore have a large corridor between premiums paid and the death benefit.

A Desirable Asset Class

Foreign nationals not only view U.S. life insurance as a tool to provide sizable death benefits at a low cost but also a contingent asset class, providing a balance against a variety of international holdings. When analyzing permanent life insurance in a portfolio, the result is that the income tax–free death benefit can have a stable expected return and low risk. This makes it ideal to use as a hedge against riskier asset classes, especially non-U.S. investments, such as private equity and hedge funds that are also highly taxed and can lead to a significant amount of capital erosion. Common policy types in a portfolio analysis include whole life, universal life, indexed universal life and variable universal life.

Jay C. Judas is the CEO of Life Insurance Strategies Group LLC and has studied the effect of using U.S. cash value life insurance to diversify investment portfolios. "When wealthy foreign nationals have a need for life insurance, their advisors are recognizing that the stability of U.S. policies makes them suitable to

include in a risk-return analysis comparison against other asset classes. In effect, U.S. permanent life insurance can perform double-duty to provide needed future liquidity and to de-risk a portfolio of international investments."

Gastélum agrees and insists an investment perspective is common for high-net-worth Mexicans considering U.S. life insurance. "The variable life insurance contracts offered by U.S. life insurance companies often have a broad platform of investment options not found elsewhere. Increasingly, I see Mexican clients attracted to U.S. VUL policies as a safe instrument through which to diversify funds earmarked for insurance protection."

Last year, one of Gastélum's clients in Mexico sought a U.S. life insurance policy in order to leave the death benefit to family residing in the U.S. The client's wealth management team insisted the client purchase a variable universal life contract and maximum fund the policy. By paying more premiums than required, the client could "store" money in the stability of the U.S. dollar inside of the U.S. life insurance policy, grow the death benefit faster and allow her wealth management team to select the investment subaccounts under the policy.

Premium Financing

A popular strategy through which to purchase nonvariable life insurance in the U.S., premium financing is a way for qualified borrowers to use third-party financing to pay for sizable life insurance premiums with minimal initial and ongoing cash flow. A one-time or series of loans are typically obtained from a lender to pay the annual premium utilizing the policy cash value and death benefit as collateral.

Lenders will often credit the cash value between 90% and 100% for the first form of collateral, and, in some situations, loans are made on a nonrecourse basis where the insured is required only to pledge personal assets to cover any cash value shortfall and is not required to provide a personal guarantee. Loan rates range from one-month to 12-month LIBOR plus 100 to 250 basis points. Clients can benefit from potential spread between the growth rate in cash value in the insurance policy versus

the interest rate charged on the loan over the long term while potentially reducing their out-of-pocket cost to acquire the policy, thus keeping more of their capital invested elsewhere earning a higher return.

Outside of the U.S., starting two decades ago, wealthy individuals began to recognize the benefits of premium financing and sought to take advantage of the strategy. Historically, these clients purchased U.S.-style life insurance policies from Bermuda branches and subsidiaries of U.S. and Canadian insurance companies and arranged to finance the premiums via their private banks in international banking centers such as Hong Kong, Singapore, Dubai, Switzerland and others.

Today, this market segment has grown and now includes not only U.S. life insurance companies but also U.S. banks offering premium financing. “It wasn’t long ago that U.S. banks or carriers were hesitant to lend to a foreign national or allow financed U.S.-based policies” says Fontanini. “But both carriers and banks have recently been getting more comfortable with premium financing of U.S. policies with foreign nationals and are opening up.”

From a planning perspective, premium financing can make the purchase of a policy less burdensome. Instead of having to liquidate assets that may be held outside the U.S. and then having to convert foreign currency to the dollar, by obtaining a U.S.-dollar denominated loan from a U.S. bank and having to provide little or no collateral, a foreign national can save time and money.

Foreign National Programs

U.S. life insurance companies are embracing foreign national clients through the creation of formal application programs. These published programs spell out a number of components and procedures, including:

- Permitted countries of residence;
- Maximum death benefit available;
- Connections, if any, to the U.S. (financial, in-country time, etc.);

- Underwriting categories available;
- Travel considerations and restrictions; and
- Solicitation and medical exam requirements and restrictions.

Prior to COVID-19, obtaining a U.S. policy for up to $40 million in death benefit was common. Responding to the uncertainty around the pandemic and its impact on mortality, carriers have reduced their available death benefit capacity for foreign nationals and limited the best obtainable underwriting class to either a standard or second-best risk category. Currently, obtaining more than $15 million in death benefit is challenging; though, the industry may return to pre-COVID-19 capacity levels and improved underwriting classifications once the pandemic has comfortably passed.

Despite these restraints, the trend over the past five years has been for U.S. life insurance companies to reduce the number and strength of ties to the U.S. required of foreign national applicants, increase death benefit capacity and generally make purchasing U.S. policies easier. Combined with the proactive marketing of their foreign national programs, these insurers are embracing the foreign national market.

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