SALI® FUND SERVICES

A JTC GROUP COMPANY

INSURANCE-DEDICATED FUNDS 101

GROWTH, TRENDS AND NEXT STEPS

OVERVIEW

Insurance-Dedicated Funds ("IDFs"): IDFs are commingled investment vehicles that accept allocations from the separate accounts of life insurance companies. IDFs allow clients to access tax-inefficient investment strategies in a tax-deferred or tax-eliminated manner. IDFs only accept allocations from Private Placement Variable Annuity ("PPVA") and/or Private Placement Life Insurance ("PPLI") contracts, the benefits of which are described in further detail below. As a commingled vehicle, an IDF can accept allocations from multiple PPVA and PPLI contracts, issued by multiple insurance companies, available to both high net worth ("HNW") and institutional investors.

Increased adoption rates among HNW and institutional investors, the punitive tax effects that HNW individuals face when they invest in certain asset classes resulting from the 2013 expiration of the Bush tax cuts, and the loss of certain income tax deductions under the 2017 Tax Act have resulted in an ever-growing number of high-quality investment managers offering IDFs. In fact, the total number of IDFs available in the market has grown from approximately 92 in September 2011 to 186 as of April 2018. The segment of the market that has seen the greatest proliferation of growth is single strategy IDFs which allow investors to make dynamic allocations to specific asset classes and tactically reallocate as market dynamics change. This market expansion has been in large part enabled by the ability of investment managers to utilize efficient, low-cost, turnkey IDF structural and administrative solutions, such as those provided by SALI Fund Services (www.sali.com), to bring their IDF to market.

The IRS rules governing PPVA, PPLI, and IDFs are the same rules that regulate the $2.1 trillion retail variable annuity and retail variable life market in the U.S. So, while the rules governing PPVA, PPLI, and IDFs are down the fairway with respect to the Internal Revenue Code, in recent years, the IDF industry has been bolstered by growing guidance through IRS Revenue Rulings, Private Letter Rulings, and pronouncements relating to the reporting on, and structuring of, IDFs. This guidance is focused on the appropriate level of transparency in IDF reporting (See PLR 201417007), the ability to structure an IDF that replicates a taxable vehicle (See PLR 201417007), and the enforceability of the Investor Control Doctrine (See Webber v. Commissioner (T.C., No. 14336-11, 144 T.C. No. 17, 6/30/15).

This additional guidance, the growing income tax drag associated with allocating to certain asset classes, and the increase in high-quality IDF investment options have resulted in steady and sustained growth in the utilization of PPVA and PPLI.

PRODUCT APPLICATIONS

PPVA and PPLI provide a myriad of benefits to investors including, but not limited to, the accumulation of investment returns on a tax-deferred basis (See I.R.C. Section 72), the ability to reallocate assets amongst IDF investment options without tax (See Rev. Rul. 81-225 and Rev. Rul. 82-54), the elimination of K-1s to end investors, and the potential elimination of income taxes at the end of the insured's life (in all cases for PPLI, but for PPVA, only if a charitable organization is designated as the PPVA beneficiary).

In addition to the more "traditional" benefits associated with PPVA and PPLI, institutions have unique incentives for accessing IDFs. Institutional PPLI, also referred to as Bank, Corporate, or Insurance Company Owned Life Insurance ("BOLI", "COLI", or "ICOLI", respectively), provides a means to offset balance sheet liabilities associated with deferred compensation plans, enhance after-tax yield of investment earnings, reduce Risk-Based Capital charges associated with direct investments in alternative asset classes, and/or provide a mechanism to achieve stable value wrap accounting treatment. Additionally, a Group Variable Annuity ("GVA") can eliminate or reduce (i) Unrelated Business Taxable Income for U.S. Tax-Exempt investors and (ii) Effectively Connected Income ("ECI") or Foreign Investment in Real Property Tax Act ("FIRPTA") taxation for Sovereign Wealth Funds or Government Instrumentalities.

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MARKET TRENDS

HNW MARKET

Tax-Inefficient Investment Strategies: Similar to strategies in the taxable investment universe, the investment strategies garnering demand within the IDF market have evolved over time. Most recently, there have been a greater number of opportunistic credit, long-short equity, quantitative trading and direct lending strategies. Such strategies are most suitable for an IDF structure given the draconian income taxes that HNW individuals may face when they allocate to these asset classes. Today, there are many IDF investment options; however, to date, the investment managers that have had the greatest success gathering assets in the HNW market have shared the common theme of investment strategy tax-inefficiency and a significant HNW investor base.

Distribution Platforms: In addition to the appeal of an expanding roster of available IDF investment options, growth in the HNW market has benefitted from the entrance of private bank and wire-house distribution platforms. By approaching this space as a platform-wide, strategic initiative, educating their financial advisors, and building out suites of IDFs, distribution partners have begun to recognize the value proposition associated with IDFs and are now making such offerings available to their clients.

INSTITUTIONAL MARKET

Risk-Based Capital ("RBC") Solution: Insurance companies face significant RBC charges (as high as 45%) when they allocate to asset classes such as private equity, real estate, direct lending or hedge funds. The RBC charges and the corresponding cash reserves required to allocate to these asset classes often make it difficult for insurance companies to achieve their investment portfolio targets given the persistent low yields in traditional fixed income markets. To compound this RBC issue, insurance companies are subject to income tax on their surplus assets, and most insurance companies have already utilized their carry forward losses from 2008 and 2009. As a solution, insurance companies can acquire ICOLI. At inception, a significant portion of an ICOLI program is made up of life insurance risk that is a general obligation of the issuing insurance company. As a result, ICOLI is classified as an "Other Than Invested Asset" for RBC purposes and has an RBC charge of 0% - 5%, even if the underlying assets are allocated to alternative asset classes. The guidelines for implementing ICOLI are well established, and the cost of ICOLI is generally lower than the cost of taxes on investment earnings. ICOLI as an income tax and capital charge solution has brought some of the world's largest alternative asset class investment managers into the IDF market.

Unrelated Business Taxable Income ("UBTI") Solution: U.S. Tax-Exempt investors such as Pension Funds, Foundations and Endowments are subject to UBTI on certain alternative asset class allocations such as infrastructure, direct lending, private equity and others. These alternative asset class allocations have helped U.S. Tax-Exempt investors achieve the return thresholds needed to satisfy obligations and/or to optimize the value put to work in the philanthropic community. In addition to the unwanted tax drag, excessive UBTI can result in the potential forfeiture of an institution's tax-exempt status. In the past, U.S. Tax-Exempt investors have utilized offshore vehicles to avoid UBTI, which can be costly and create certain administrative complexities for U.S. Tax-Exempt investors. Conversely, a Group Variable Annuity ("GVA") allows U.S. Tax-Exempt investors to allocate domestically through a very simple structure without incurring UBTI. The elimination of UBTI is achieved because the separate account of the life insurance company that issues the GVA is the investor while the U.S. Tax-Exempt investor is the owner of the GVA contract. As a result, U.S. Tax-Exempt investors do not realize any tax on the accumulation or distribution of proceeds in a GVA. GVAs have a history, dating back to the early 1990's, of enabling U.S. Tax-Exempt investors to allocate without UBTI; to date, approximately $50 billion have been invested through GVA contracts.

NEXT STEPS

INVESTORS - FINDING AN INSURANCE BROKER

Individuals and institutions looking to acquire PPVA or PPLI will need to engage with a licensed insurance broker. Insurance brokers often play a critical role in providing marketplace education and policy design, as well as helping investors to navigate the investment manager and insurance company landscape. Additionally, they play an important role in the ongoing administration, reporting, and maintenance of a client's PPVA and/or PPLI program. The selection of a capable insurance broker is, in most cases, the first step a prospective purchaser of PPVA or PPLI should take if they wish to allocate to IDFs.

INVESTMENT MANAGERS - LEVERAGING A TURNKEY PLATFORM

Investment managers seeking to launch an IDF offering can leverage a turn-key IDF administrator. IDF administrators help investment managers create IDFs with minimal expense and effectively navigate the IDF approval process with multiple life insurance companies. Capable IDF administrators serve as a consistent and trusted counterparty to life insurance companies and ensure that the ongoing administration is managed in compliance with tax and regulatory requirements. By delegating many of the operational aspects of managing an IDF to a turnkey IDF administrator, investment managers can remain focused on what they do best – managing money and strengthening client relationships.

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KEY CONTACT

For additional information, please contact Jonas Katz, Chief Marketing Officer of SALI Fund Services, at jkatz@sali.com or (212) 527-8013.

Jonas joined the firm in 2016 and is responsible for the development and management of the firm's relationships with life insurance companies and investment managers. To survey a list of available IDF investment options, consider visiting the SALI IDF Portal, which provides a dashboard for IDF market information along with relevant publications and source documents, at www.saliportal.com.

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ABOUT US

Founded in 2002, SALI Fund Services provides a turn-key solution for the creation and administration of Insurance-Dedicated Funds (IDFs). SALI administers IDFs for a broad range of investment managers, from boutique hedge funds to the largest wealth management institutions in the world.

SALI enables investment managers to create tax compliant IDFs which can be attached to insurance company Private Placement Variable Universal Life (PPVUL) and Private Placement Variable Annuity (PPVA) investment account platforms. On an ongoing basis, SALI serves as the fund administrator to the IDF.

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