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Saving a Nest Egg for a Favorite Charity

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The growing number of wealthy Asian families looking to combine estate planning with philanthropic giving has spurred private banks to look for more ways to enable their clients to fulfill their goals.

One of the newly popular vehicles is universal life insurance, which offers liquidity and control not always found in traditional vehicles, like a charitable trust or foundation.

"More Asian clients are now using universal life insurance to give to charity when they are gone, as it allows them to give away much more substantial sums than they might have otherwise been able to," said James Aitken, managing director of Private Wealth Solutions at HSBC.

A universal life insurance policy pays out upon death of the insured and, depending upon the type of policy, it may be possible to guarantee the amount of the proceeds. Universal life policies typically carry a minimum rate of return known as a crediting rate. The insurance company, after deducting the cost of insurance, credits the policy with the balance, helping to build up the cash value while the policy remains in force.

David Hayward Evans, head of philanthropy services and values-based investing at UBS, said a universal life insurance policy offered a measure of certainty for both donor and recipient. With a guaranteed a rate of return, the donor will know exactly how much will be left to the charity. Because the payout is triggered automatically upon the death of the donor, the recipient receives the funds directly and relatively quickly.

The other side of the coin is that the donor and the beneficiary will not know precisely when those assets will become available, nor how much they will "cost" the benefactor in premiums.

A universal life policy also offers flexibility with the premium payments. Donors can make a one-time premium payment or opt to pay an annual premium, typically over a 10-year period.

Private banks can help finance the policies. Michael Troth, head of Asia for Citi Trust in Singapore, said that typically the bank would lend 70 percent of the lump-sum premium and take the policy as collateral for the loan.

This plan, he added, is particularly appealing in a low interest rate environment: "The insurance policy pays you a guaranteed minimum rate of return, and given the current level of interest rates, it may well be possible to receive a higher rate of interest on your insurance policy than you are paying on your loan."

As with all arbitrage, however, there is a risky side: “If interest rates spike, the cost of your borrowings will quickly outpace the rate of return you’re getting on your policy,” Mr. Troth said.

Christian Stewart, managing director of Family Legacy Asia, a firm based in Hong Kong that provides advice on succession, said that universal life insurance could be especially useful to families that tie up most of their wealth in the family business during their lifetime.

“By taking out a life insurance policy, a businessman who has most of his money invested in his own company will have the liquidity to leave money to charity upon his passing away,” Mr. Stewart said. “While he is alive the value of his policy can also be determined by the value of his business, so if he has a large company he could take out a large insurance policy.” Most universal life policies have a death benefit of at least $10 million, Mr. Stewart noted.

In most legal systems life insurance does not have to go through probate, the legal process of administering an estate by resolving all claims and distributing the deceased’s property under the valid will. In cases where heirs may not support the donor’s wishes, Mr. Stewart said, giving through an insurance policy removes a potential roadblock.

Giving through insurance can also shield recipients from unwanted attention. “Probate is a public process, so the provision that you make in your will is open to the public to review,” Mr. Stewart said. “The provisions that you make in an insurance policy are confidential.”

One drawback with giving through a life insurance policy — as opposed to giving while you are alive — is the possible lack of control over how the money is spent. “How can you be sure that the charity continues to be operated in the fashion that you were used to while you were alive? Who plays that monitoring role?” Mr. Stewart said. “If you directly name the charity as the policy beneficiary, it might be hard to do so.”

Mr. Troth of Citi Trust said that the vast majority of his bank’s clients placed their universal life insurance policy into a trust. “The benefits are numerous,” he said. “First, when it comes to the time to claim on the policy, it’s easier to do so when it’s in a trust run by a third party. The family will be grieving and dealing with many issues and the last thing they want to do is collect insurance proceeds or try to figure out where you have placed the policy. So from an administrative point of view, putting your policy in trust with an institution takes away a lot of that burden.”

“Secondly, the proceeds of the policy will be paid into the trust, and the trustees will manage those funds in accordance with the terms of the trust, which will follow your wishes,” he said. “This way you can have certainty that your wishes will be carried out.”