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# OVERLOAN PROTECTION RIDERS

An overloan protection rider (OLP) is a life insurance policy rider designed to help policyowners manage policy loan balances and avoid an inadvertent lapse and possible taxable “boot.” When the outstanding policy loan exceeds 90% of the policy account value, utilizing OLP may be a valuable alternative to self-managing a policy.

Understanding how OLP and its variations works is key to unlocking the value it provides and can help you protect your clients’ interests.



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## WHY IT MATTERS

One of the valuable benefits of life insurance is using the savings aspect to accumulate cash value over an individual's working years. As the individual enters retirement, a popular strategy is to use accumulated cash values to supplement retirement income through a systematic program of withdrawals and loans.

### “BOOT” CAMP

**In Old English, “boot” referred to something advantageous or good. In the world of tax, “boot” has come to mean an addition or advantage provided or given. Taxable boot in life insurance includes the taxable benefit derived from the discharge of indebtedness. IRC § 61(a)(11). And now you know the meaning of “boot” to boot.**

Outstanding policy loans must eventually be paid back. Many policyowners plan to pay back the loan at death, by netting the outstanding loan balance against death proceeds. If a policy is surrendered or lapses prior to death, the total outstanding loan balance is considered a distribution of account value at the time of termination and becomes taxable to the extent it exceeds the policy's cost basis. This distribution of the outstanding policy loan balance is commonly referred to as boot, as the owner receives taxable value when the outstanding loan balance is functionally extinguished.

Policy Managers may want to adopt best practices for utilizing OLP when servicing policies with large outstanding loan balances to mitigate liability exposure for policy management.

## HOW DOES OLP WORK?

When a policy has a loan and the loan balance grows beyond a set percentage of the policy's account value, the OLP is exercised. At exercise, a one-time rider charge is applied that covers all future policy charges, including cost of insurance and expense charges. This essentially puts the policy into a “paid up” status, and the policy continues in force until the death proceeds are paid. Once the OLP has been exercised, no further policy transactions are allowed (e.g., premiums, loans, and withdrawals).

On the surface, OLP appears straightforward. However, carrier variations in the mechanics, exercise conditions, and features of OLP can make illustration, comparisons across carriers, and utilization of OLP challenging.

### GENERAL SUMMARY OF CARRIER OLP EXERCISE CONDITIONS

- Insured's attained age above 65 or 75, and policy in force for at least 10 or 15 years
- Loan balance at least 90%–98% of the total account value, which typically requires that the policy was funded to generate sufficient cash value growth to exceed the face amount before maturity (e.g., guideline premiums)
- Unloaned policy account value cash value needs to cover any charge for the rider (e.g., 3% of total policy account value, which includes the outstanding loan balance)

The following table demonstrates how illustrated values could be impacted by the utilization of an OLP. This example is based on an initial guideline premium test (GPT) policy where the face amount is \$500,000 and funded at a level to be in the cash value corridor when distributions of withdrawals and loans start at age 65. The example shows how the OLP rider may work when it triggers, in this case at attained age 80.

Insured Age	New Loan	Rider Charge	Outstanding Loan Balance	Unloaned Account Value	Total Account Value	Loan Ratio	Meet Exercise Requirements	OLP Active	Total Death Benefit	Net Death Benefit
78	\$70,000	\$0	\$765,000	\$95,000	\$860,000	88.9%	No	No	\$903,000	\$138,000
79	\$70,000	\$0	\$855,000	\$30,000	\$885,000	96.6%	Yes	No	\$929,250	\$74,250
80	\$0	(\$26,500)	\$875,000	\$2,500	\$877,500	99.9%	Yes	Yes	\$921,375	\$46,375
81	\$0	\$0	\$895,000	\$0	\$895,000	100%	Yes	Yes	\$939,750	\$44,750

In this example, there is a one-time charge at exercise of \$26,500 to the unloaned account value to trigger the rider. After the OLP is exercised, the unloaned account value goes to zero, but the policy remains in force with a modest death benefit. This policyholder will not be able to take additional loans or withdrawals for the policy; however, they are no longer at risk of taxable boot. Note that other benefits, such as LTC riders, will typically be terminated with exercise of the OLP.

The main benefit of OLP is to remove the burden of managing a heavily loaned policy. Had the OLP not been exercised in this scenario, the account value would need to be carefully monitored to ensure the policy does not inadvertently lapse. It is possible through monitoring to keep the policy in force, in part by mimicking the OLP feature, such as by stopping future loans, moving money to the fixed account, and frequently monitoring the account value.

## BEST PRACTICES FOR OLP

### RECOMMENDED FEATURES OF OLP RIDERS

- Automatic inclusion – Eligible policies should have OLP automatically added at issue.
- Automatic exercise – The rider should assume that exercising OLP is pre-elected. The carrier should notify the policyowner that exercising conditions have been met and the OLP will be exercised unless the policyowner opts to defer exercising until a later time.
- Alert procedures – The rider may spell out the alert procedures, such as automatically notifying the policyowner prior to processing a loan request that would result in the policy meeting or exceeding the exercise conditions.
- Definition of life insurance (DOLI) test – It is common for carriers to only offer OLP with a guideline premium test (GPT) design. The reason for this is that higher rider costs make a policy designed to meet cash value accumulation test (CVAT) uneconomical. In CVAT designs, more death benefit net amount at risk is required than GPT at older ages. However, at least one carrier offers OLP with CVAT. If you intend to use OLP, make sure it is available with your selected DOLI test.
- Remaining death benefit – The combination of trigger threshold, rider charge, and future policy charges

should allow for a net death benefit to be paid (e.g., in excess of \$10,000) for the remainder of the policy.

- Rider exercise charges – Charges may be fixed or vary by age. The typical charge is 2%–4% above age 85, 3%–5% below age 85.

## ILLUSTRATING AN OLP

There is a wide variation among the carriers' illustration capabilities to demonstrate OLP. Here are some tips to make the OLP show up in an illustration:

- Set any solve targets to age 120 and at least \$1,000.
- Check the illustration to make sure it lasts until at least age 120.
- Make sure the distribution stream of withdrawals and loans is what is being requested.
- If the OLP is illustrating successfully, you will see a rider charge at the time the rider is exercised and takes effect.
- If the illustration is unclear, ask the carrier to confirm that OLP is available with the policy configuration.



## ISSUE AND POLICY SERVICING

- Since OLP does not incur any charge unless it is exercised, best practice is to include the rider, if available, on any policy where significant use of loans is anticipated. When the policy is placed, ask the carrier to confirm availability of OLP with the policy configuration.
- Confirm OLP elections are made at time of application.
- Ask the carrier for administrative procedures to exercise the rider once the insured meets the policy age and duration criteria.

- Begin OLP monitoring as part of in-force reviews when the policy meets the policy age and duration criteria, or when a substantial policy loan regime is being executed.
- Confirm the ratio of total outstanding policy loan to total account value as part of the in-force review process. When the ratio exceeds 90%, begin monthly policy monitoring to make sure OLP is exercised.
- Once OLP is exercised, the in-force review should ensure it is performing as expected.
- When a death claim is processed, confirm with the carrier that OLP was administered until death.

### M CARRIER OLP RIDER FEATURES AS OF MAY 2019

	John Hancock	Lincoln	Nationwide	Pacific Life	Penn Mutual	Prudential	Symetra	TIAA
<b>Rider Charge</b>	Varies by DOLI test and age when exercised 8.0%–0.4%	3.00%	Varies by age	Varies by age when exercised 3.80%–1.12%	3.50%	3.50%	5.00%–0.475% depending on age	Endorsement 4% 65–74 3% 75–94 1% 95+
<b>Min. Loan Indebtedness %</b>	95%	Variable: 93%–99% Fixed: 95%–99%	Varies by age 95%–99%	Loan debt must exceed total face	96%	95%	93%	96%–99%
<b>Min. Age/ Duration</b>	75–100/15	75/15	75/15	75/15	75/15	75/15	75/15	65/10
<b>Can Be MEC?</b>	No	No	No	No	No	No	No	No
<b>Exercised Automatically</b>	No	No	No	No	Yes	No	No	Yes
<b>Exercised by Written Request</b>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
<b>Revocable</b>	No	Possibly	Possibly	Possibly	Possibly	No	Possibly	Possibly
<b>DOLI</b>	Both	GPT only	GPT only	GPT only	GPT only	GPT only	GPT only	GPT only
<b>AV Minimum</b>	Enough to cover rider charge	Enough to cover rider charge	\$100,000	Enough to cover rider charge	Enough to cover rider charge	Enough to cover rider charge	Enough to cover rider charge	Enough to cover rider charge
<b>Illustration Capability</b>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

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