Second to Die Rider

An exciting concept in the area of life insurance products for estate planning needs is the Second to Die rider offered by a number of carriers. It is a concept that is simple by nature, yet provides tremendous planning capabilities. The Second to Die rider is generally attached to a permanent life insurance policy. What the rider offers is additional flexibility. Essentially, the rider allows the beneficiary of the permanent or "base" policy additional options:

- Use proceeds of base policy as life insurance proceeds
- Use the proceeds to obtain coverage on another life

This "other life" does not necessarily have to be the beneficiary. It can be anyone with whom the original policy owner had an "insurable interest."

The key to this coverage is that it is underwritten at the time that the base policy is issued. At the death of the person insured by the base policy, the coverage on the "other life" is guaranteed issue, without any underwriting.

The continuing coverage can be either "paid-up" or it can be "premium paying" coverage. In either case, the coverage by the rider is original issue, meaning the policy issue date of the rider-generated policy is the same as the original base policy.

While it varies from insurer to insurer, there is generally an increase allowed in the face amount from the base policy to the rider generated policy. The maximum available is a five times step-up, i.e., if the base policy is $100,000 then the maximum Second to Die rider generated coverage would be $500,000.

In general, most insurers are allowing additional flexibilities. These include the ability to select death proceeds, paid-up coverage, and premium paying coverage in any combination and amount desired. While the policy illustrations generally illustrate that the proceeds are used to "fund" the rider generated policy, in most instances the insurer does not require these funds to come specifically from the base policy.

The necessity for funding arises from the fact that the rider generated coverage is original issue. As such, the reserve must be paid in to create the contract. In the advent of high interest reserve contracts (i.e., 6%), lesser amounts are needed to create coverage on the second person.

This contract was designed for use in the estate-planning context. In order to understand its application, it is necessary to examine estate planning after the Economic Recovery Tax Act of 1981. This law provided the unlimited marital deduction. The unlimited marital deduction has, in turn, given rise to post-mortem estate planning because the unlimited marital deduction can be a potential tax trap.

For example, if both spouses have sizable assets, and if the unlimited marital deduction is utilized, then the total tax bill (both estates) is increased. This occurs because of the graduated nature of the estate tax. The same result occurs when estate assets are rapidly increasing in value. If one pays the estate tax at the first death, the appreciation will be eliminated from taxation at the second death.

On the other hand, the unlimited marital deduction can be effective, particularly if the surviving spouse will consume assets. Many attorneys draft the marital deduction so that it can be selected on a "post-mortem" basis (after the death of an individual.) The vehicle generally used in this process is the qualified disclaimer.

The Second to Die rider works effectively in this type of estate plan. If the unlimited marital deduction is utilized, deferring expenses to the second death, then the maximum amount of Second to Die coverage will be elected. The proceeds will not be taken in cash, but will be "rolled into" the Second to Die coverage. However, if some estate taxes are to be paid at the first death, proceeds will be used at that time, and only any excess will be used to create the Second to Die coverage.

The advantage of the Second to Die rider in this context is that if a joint life Second to Die policy is used, the only way to acquire funds at the first death is to make a policy loan and be burdened with interest payments. The Second to Die rider reverses this process. It releases cash at the first death, and then, if continuing coverage is desired, it can be funded.

In conclusion, the Second to Die rider offers unique planning and product opportunity with significant flexibility.