

Premium Financing 101

For high-net-worth clients in need of life insurance, Premium Financing is an excellent option for securing a significant amount of coverage without having to liquidate assets or tie capital to do so.

At its most basic, premium financing allows wealthy people to borrow money to pay large life insurance premiums. Generally, premium financing should be considered by clients with large estates who need to purchase substantial amounts of insurance but do not have the available cash to pay the premiums on such a policy. As with anything, there are pros and cons to such a practice, which we explore in the remainder of this article.

Premium finance loans are often provided by a third-party finance entity known as a “Premium Financing Company”; however, insurance carriers and brokerages occasionally provide premium financing services. Call 1-877-888-0166 to find out how Senior Market Sales can help with your Premium Finance needs.

Benefits of Premium Financing:

- 1. Attain a large amount of life insurance without liquidating investments or assets to pay for it.** Premiums for the high-face-amount policies that many wealthy individuals require can cost hundreds of thousands of dollars a year. While the client may be worth significantly more than that, they may not have enough liquid capital available to pay such high premiums and may not be willing to liquidate assets to raise the necessary capital. Premium financing allows them to attain sufficient insurance while keeping their assets intact—using them as collateral.
The death benefit can then be used by the beneficiaries to pay off the premium finance loan, to pay estate taxes, or for income replacement.
- 2. Reduce or Eliminate Estate Tax.** By purchasing the life insurance policy in an Irrevocable Life Insurance Trust (ILIT), a high-net-worth individual can save his or her heirs from paying estate taxes on life insurance proceeds.
- 3. Reduce the amount of gift tax on the estate.** One of the benefits of life insurance premium financing is that the money that is paid to the ILIT to fund the life insurance policy will later be deducted from estate taxes.
- 4. Effective Business Planning Tool.** Businesses often use life insurance to protect against a key employee or partner passing away. Policies for Key Person Insurance or Buy/Sell Agreements can often be quite large. Premium financing allows the business to attain the needed coverage without tying up capital or sacrificing profitable investments.

5. Current conditions are ripe for Premium Financing. Premium financing loans usually feature a variable interest rate based on the London Interbank Offered Rate (LIBOR). As of May 26, 2009, the one-year LIBOR rate is at 1.66%, according to BankRate.com (keep in mind the lender will usually add a 100 to 350 bps spread to that based on the client's collateral and credit-worthiness). Compare that to a one-year LIBOR rate of 4.30% back on December 31, 2007 and it's easy to see that Premium Financing loans are going at a significantly discounted rate right now.

Risks Associated with Premium Financing:

It is important that your client is aware up front of potential risks associated with premium financing. But you don't have to be a premium finance expert. If you work with Senior Market Sales and North American (NACOLAH), you can turn the case over to their experienced sales support team and they'll help you develop it, select the appropriate product and run illustrations.

- 1. Insurance Rate Risk** – Because most premium financing agreements are based on a variable interest rate, your client does run the risk that rates will increase more than anticipated and they'll be required to come up with more money or more collateral to make up for it.
- 2. Collateral Risk** – If the value of your client's collateral falls below the level required by the lender to satisfy the loan, your client may have to provide additional collateral. If they do not have additional collateral, the entire loan could be called.
- 3. Death Benefit Risk** – There is a chance that the death benefit on the insurance policy may end up being less than expected. Once the outstanding balance on the premium finance loan is repaid, it is possible the remaining proceeds may not be enough to satisfy estate liquidity needs, putting the insured's assets at risk.

NACOLAH has partnered with Capital Maximization Strategies (CMS) as its premium finance company. To meet the requirements of CMS's premium finance program, the client must be age 75 or younger and have a net worth of \$5 million or more, not including primary residence.

How often do you find yourself across the table from a client who meets those criteria? For the average life insurance agent, the answer to that question probably falls somewhere on the spectrum between 'rarely' and 'never.' But if you ever do find yourself with one of these once-in-a-lifetime cases, Senior Market Sales and NACOLAH have the resources and expertise to help you meet their needs.

Download the [Capital Maximization Strategies brochure](#) for more information on Premium Financing from NACOLAH.