COULD YOUR CLIENTS BENEFIT FROM PREMIUM FINANCED LIFE INSURANCE?

Depending on your client's goals and objectives, life insurance offers a myriad of benefits that may prove to be the right solution to your client's specific needs. Whether your client is interested in providing for loved ones, perpetuating personal or business assets, minimizing estate tax liability, or benefiting from the favorable tax treatments associated with cash accumulation policies, life insurance may warrant your proper consideration.

When dealing with high-net-worth clients, their need for additional financial protection significantly impacts the amount of coverage they ultimately need. The increased amount of coverage results in larger premiums that often create a cash flow or liquidity challenge. Fortunately through premium financing, your high-net-worth clients are able to purchase the insurance they need without liquidating investments or otherwise disrupting their standard of living or cash flow.

This strategy provides a great solution for clients who understand and appreciate the benefits of leveraging money or other assets. While it's a great solution, it is certainly not for everyone. Generally, premium finance is only available to high-net-worth individuals – those earning greater than $500,000/yr., and with a net worth starting at $5 million.

HOW DOES IT WORK

Premium finance has traditionally been used with whole life and universal life products (fixed and indexed). Rather than absorbing the full cost of the premium, the client borrows money from a third party lender. The loan is secured through collateral and cash values inside the policy. In addition, the lender takes an assignment on the death benefit equal to their remaining interest, or the outstanding balance of the loan. The lender pays the annual policy premiums while the client covers the interest on the loan. Most loans will carry an interest rate at a spread over London Interbank Offer Rate (LIBOR). As the life insurance policy is credited with annual dividends, the cash values inside the policy grow and the need for pledged collateral to cover the cost of the loan is diminished.

With the current low-interest rate environment, the policy's cash value is able to grow at a faster rate than the interest on the outstanding loan, which creates an opportunity for positive arbitrage. Once the policy accumulates enough cash value, that cash value can be used to repay the outstanding loan requirement.

Even as interest rates rise, premium finance may still be a viable solution. Financially savvy clients can use the funds they would spend on life insurance towards their investments that yield more profitable returns. Why take money out of profitable investments, or risk paying capital gains taxes, when you can finance your premium and allow your investments to grow?

WHAT ARE THE BENEFITS OF PREMIUM FINANCING?

>>> By leveraging existing assets, the insured is able to reduce out-of-pocket expenses, thus preserving their current standard of living and cash flow.
>>> When structured properly, the policy provides a tax-free benefit not included in the estate, allowing the insured's financial legacy to be efficiently transitioned.
>>> May provide a positive arbitrage between the crediting rate on the policy's cash value growth and the carrying cost of the loan.
>>> May reduce annual gifting for trust-owned policies.

ITEMS TO CONSIDER

>>> Interest rate loans are generally based on LIBOR, which may allow rates to increase and ultimately affect the carrying cost of the loan.
>>> If the policy's cash values accumulate slower than initially anticipated there may be a need for additional pledged collateral.

Although the concept appears simple, executing it can be complex and therefore requires legal and tax consideration. Given the complexities of this solution, it is important to work with your trusted broker, and a team of skilled tax and wealth advisors. Additionally, it is essential to monitor the policy annually to ensure it is performing as originally illustrated and that it continues to meet the owner's original intentions.

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