IS PREMIUM FINANCED LIFE INSURANCE THE RIGHT SOLUTION FOR YOU?

Depending on your goals and objectives, life insurance offers a myriad of benefits. Whether you are 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 be the right solution for you and your family.

As an individual's wealth increases, so does their need for financial protection. With HNW individuals, the increased need for financial protection largely impacts the amount of life insurance coverage required, thus creating larger premiums that could result in a cash flow or liquidity challenge. Fortunately through premium finance, high-net-worth individuals are able to purchase the insurance they need without liquidating investments or otherwise disrupting their standard of living or cash flow.

This premium financing strategy provides a great solution for those 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., 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 proposed insured 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 allowing the insured full ownership of the policy free from any ownership interest from the bank.

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

WHAT ARE THE BENEFITS OF PREMIUM FINANCING?

>>> By leveraging existing assets, you are able to reduce out-of-pocket expenses, thus preserving your current standard of living and cash flow.

>>> When structured properly, the policy provides a tax-free benefit not included in your estate, allowing your financial legacy to be efficiently transitioned to the next generation.

>>> 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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