FINANCIAL INDEPENDENCE GROUP
PREMIUM FINANCE TOOLKIT

Premium Finance Overview

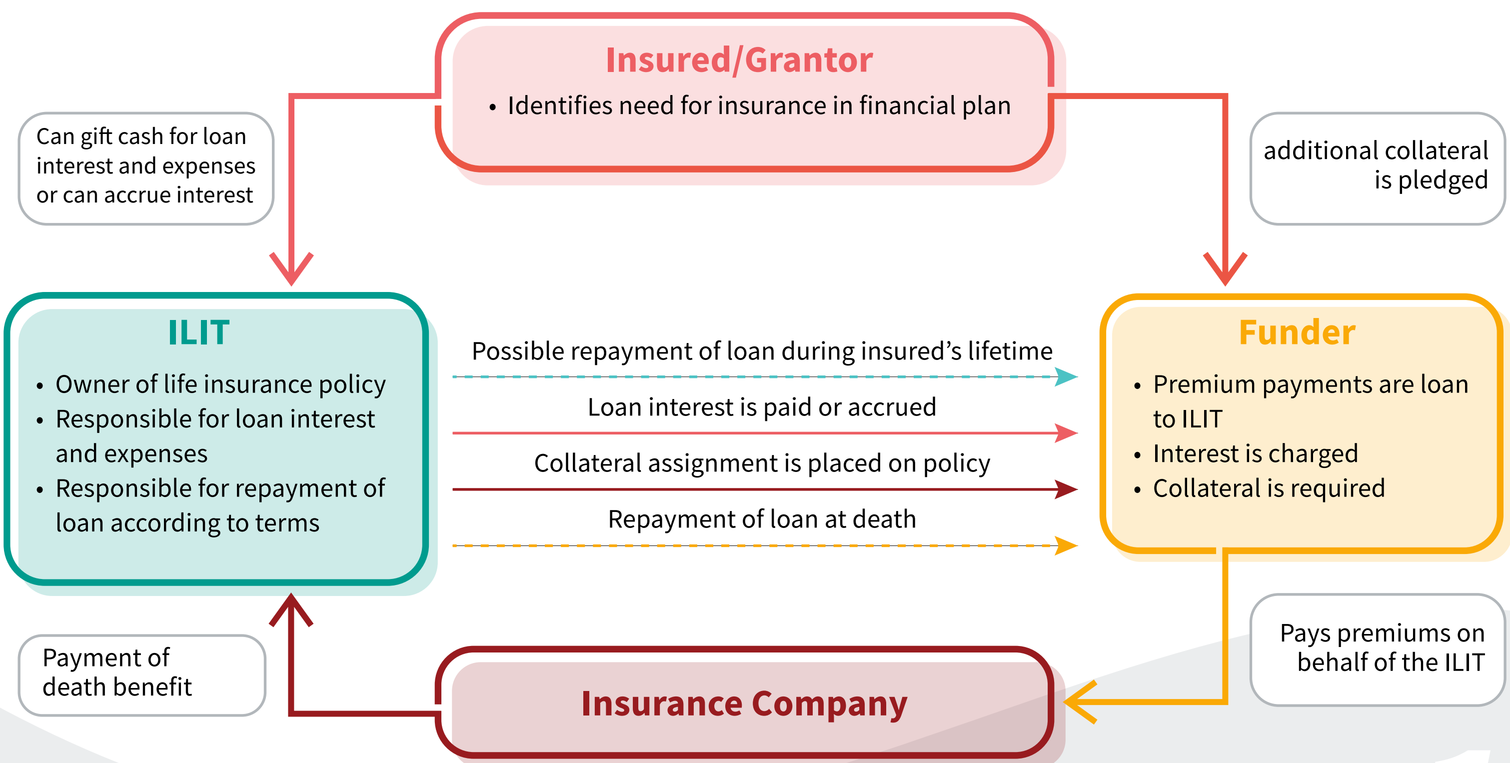
Premium-financed life insurance is an arrangement where the premiums used to pay for a large life insurance policy are paid via a bank loan instead of being outright paid by the policy owner.

This design is typically utilized by high net worth (HNW) or ultra-high net worth (UHNW) families who need life insurance coverage that prefer leverage but have cash flow constraints or prefer not to liquidate high-performing assets to pay the life insurance premiums. In exchange for giving a loan for the premium payments, the bank will charge an interest rate on the loan and use the life insurance policy as collateral.

Typically, there's some additional collateral the family will need to assign, especially in the policy's early years. This loan structure can possibly provide the opportunity for investment leverage to be realized if the money the family can keep in a business or other investments can earn a return higher than the loan interest rate charged by the bank.

Annual loan interest on the borrowed premium payments is typically paid in full or in part by the policy owner (typically an irrevocable life insurance trust, or ILIT). The loan can be paid in full in the future when the policy's cash value is higher than the outstanding loan amount or at the insured's death. At death, the policy owner's designated beneficiaries will receive the death benefit over and above the outstanding loan if it hasn't already been repaid.

Premium Finance Flow Chart Example



TYPICAL IMPLEMENTATION PROCESS FOR PREMIUM FINANCE CASE

1. **Identify a Prospect:** Normally, suitable prospects will be wealthy clients with an insurance or estate planning need. Plus, a minimum net worth of $5 million with constraints or preference against liquidating capital to fund premium payments is typical.

2. **Select Funder or Premium Finance Vendor:** A premium finance vendor is a partner who works with finding and negotiating the best loan terms and packaging the premium finance case to the carrier. If licensed, a vendor will typically participate in the compensation generated by implementing the insurance strategy at a pre-determined rate.

   Carriers may work with approved vendors who have gone through a due-diligence process with the carrier. Vendors will also model and help present the design to families and should help manage the plan and policy in the future. You can reach out to your FIG private client group to discuss possible vendor relationships.

3. **Underwriting Informal Offers are Obtained:** The insured begins submitting medical and financial information and may even complete paramedical exams to determine insurability and rate classification.

4. **Financial Underwriting:** Premium finance cases require more financial underwriting than a traditional life insurance sale. Setting expectations with clients that they'll need to provide detailed information to prove their financial situation is strongly recommended.

5. **The Case is Modeled and Sent to Funders:** Once insurability is determined, the design can be modeled and sent to funders to negotiate loan terms such as loan rate, loan duration, fixed or variable rate, collars or caps to rate, collateral accepted, and repayment terms.

6. **Funder Approves Pricing:** A loan term sheet is provided and sent to the selected insurance carrier.

7. **Policy Ownership Structure is Completed:** A trust is usually set up, or an existing trust is utilized.

8. **Underwriting Completed and Insurance Policy Issued:** The formal application is submitted to the selected insurance carrier along with the premium financing details. The carrier can then issue the policy and request delivery requirements are signed by all parties (insured, trustee, agent, and funder).

9. **Funder or Bank Wires Premium:** Premium payment is wired to the carrier and the policy is put in force while collateral assignments are completed as required.

10. **Ongoing Management of Policy and Loan:** Each year, loan term, policy cash value, and collateral are reviewed and adjusted to optimize performance and leverage.

PREMIUM FINANCE FACTORS TO CONSIDER FOR SUCCESS & OPTIMIZATION

Loan Rates and Terms

HNW clients typically can obtain favorable loan rates and durations. The lower the rate and the longer a low rate can be negotiated, the more it can positively affect the plan's ability to create positive arbitrage for the client. As with other loan forms, more attractive rates can usually be obtained the higher the amount borrowed is. Loans will have a maturity date at which they may be able to be refinanced at current rates or moved to another lender or bank.

Variation in Loan Interest Rates in the Future

A risk to any premium finance plan is the future of loan rates. If a loan rate can be fixed for a certain number of years or have a cap or collar (max rate) that can be purchased, that'll help reduce the interest rate risk associated with the plan.

Health of the Insured

The economics of the design relies heavily on the health and assigned rate class of the insured: the lower the life insurance policy charges, the more efficient the plan design.

Payment of Loan Interest

It's typical for the borrower to pay annual loan interest each year. This reduces the risk of the loan growing to an amount greater than the policy's cash value and improves the ability to repay the loan via policy proceeds.

Type of Life Insurance Product Used

Fixed life insurance products are usually used in premium financing designs. The most common product design uses an IUL product due to its upside and equity-linked potential that clients desire—along with minimum guarantees that banks prefer when using the policy as loan collateral. Illustrations and future modeling should be run with realistic assumptions. A lender will likely challenge any unrealistic assumptions, delaying the process.

Insurance Design

Premium finance cases can be structured and designed for either a death benefit design or a cash accumulation design. In a death benefit design, the plan is structured to try and achieve the maximum death benefit for the lowest cost. For a cash accumulation design, a lower death benefit may be structured to allow for more efficient building of cash value inside the policy. This cash value can grow in a tax-free environment and be accessed as tax-free income in the future using policy loans and withdraw to basis in an adequately structured non-MEC policy. Note that premium financing can limit the availability of policy loans if used as collateral.

Collateral

Additional collateral is typically required in addition to the life insurance policy's cash value at the start of the plan. Clients need to be aware and comfortable posting additional collateral and understand that the amount can change year-to-year based on the policy's performance. Collateral requirements are reviewed each year by the bank, and the required amount can and likely will change each year. If loan rates rise higher than the policy's crediting rate, negative arbitrage can occur, resulting in the policy's cash value not growing as fast as the outstanding loan balance. Common acceptable forms of collateral are cash, cash equivalent, and liquid or marketable securities.

Loan Repayment

Loans can typically be repaid before death. If the loan interest isn't being paid or collateral isn't posted, the bank can generally call the loan. If the life insurance policy has performed well and the policy cash value is well over the loan, it can be advantageous to repay the loan.

Exit Strategy

Planning for an exit strategy or repayment of the outstanding loan prior to death is required by most carriers in the initial design. Repaying the loan at the insured's death is an option, but there should be a plan to exit the premium finance arrangement sooner if desired. An exit strategy can be flexible during the actual administration of the policy.

Ownership Structure

The life insurance policy can be held inside or outside the policy owner's estate. Typically, a trust will own the policy, but that's not required.

IDEAL CLIENTELE FOR PREMIUM FINANCING

Ideal Age Group: Ages can vary. Generally, premium financing can work for younger clients who have a strong exit strategy to repay the loan.

Has a Need for Life Insurance: Premium financing isn't a primary reason to purchase life insurance. It can fit particular situations and clients with a significant need for life insurance and for whom other forms of premium payment methods are less attractive.

Larger Net Worth: The client will need to justify the death benefit application financially and any in-force policies already in place. A net worth over $5 million can be a good benchmark.

Insurable Medically: Standard or better rate classification is ideal for premium financing. The lower the policy charges, the lower the premium loan is which can create a more efficient design. Some scenarios may work for a client rated "Table 2" or worse, or a spouse may make more sense to use as the insured.

Client Understands Leverage: It's essential that the client fully understands leverage and how it works in premium financing. The loan obtained from the bank will have interest rate risk, duration risk, and potential collateral posting risk that another type of loan wouldn't have.

Team of Advisors: Does the client have a team of legal and tax professionals they work with that can help review all tax, trust, and other documentation related to how a premium financed life insurance policy operates? It's vital to fit premium financing into a client's overall financial and estate planning strategy.

Able to Post Collateral: The client must be willing and able to post collateral as needed throughout the duration of the plan. Collateral can only be estimated for future years.