

Problem solving for the large life case: Premium Financing

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By their very nature, large* life insurance cases require creativity. Premium financing is one technique which overcomes obstacles to larger sales by enabling clients to preserve cash flow, avoid capital gains tax on asset sales, and leave their investments undisturbed. Let's take a look at the details.

What it is

Simply put, it is the ability to finance large life insurance premiums through an independent third party creditor, relieving the prospect of large initial cash outlays for premiums and eliminating the need to gift more than the annual exclusion amount to an insurance trust.

At AIG Life Brokerage, the premiums themselves are typically financed through a large, independent third party lender, and the policyowner currently pays loan interest in advance. The premium paying period is usually limited; i.e. no more than ten years, and the loan balance is ultimately repaid from funds outside the life policy, or, from death benefits. The death benefit includes a return of premium rider so that it is sufficient to pay back the lender and retain a level death benefit for the beneficiary.

The loan interest rate is based on the one year LIBOR rate (London Interbank Offered Rate), plus a profit margin of 175 to 300 basis points. Loan interest rates may vary from year to year, and borrower financials are reviewed annually in order to maintain credit worthiness. Generally, borrowers are required to be entities (trusts or businesses) and the policy cash value and death benefit serve as loan collateral although additional liquid collateral from the estate owner may be required on a case by case basis.

The scenario

The typical premium financing client has a large need for estate liquidity, but hesitates to commit a large amount of cash flow to life insurance premiums because of current investment or business considerations. The estate owner normally believes that he/she can generate greater returns on his/her money than the insurance company can credit in a life policy. Consequently, by financing the premium, the client retains the difference between the loan interest payment and the actual premium and is free to invest this difference in an investment portfolio or business.

*Premium financing is available for cases with a minimum annual premium of \$100,000 and a minimum client net worth of \$5 million.

As long as the after tax earnings rate on the invested funds is greater than the loan interest rate, the invested funds should be sufficient to eventually pay back the loan. For example, if the premium financing rate were 5.5.% and the after tax earnings rate achieved by the estate owner were 7.5%, there should be sufficient assets outside of the insurance policy to eventually repay the cumulative premium loan.

To summarize

Suffice it to say that premium financing is a creative way for finding premium money for large life cases. It is a cash flow solution for the estate owner with a large insurance need who is reluctant to commit income to life insurance premiums yet confident that he/she will earn more on the money retained in a portfolio or business than the borrowing rate for the premium loan. For additional information about premium financing, contact Advanced Sales at AIG Life Brokerage.