

**Premium financed life insurance: A client-friendly program**  
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Over the years, I've reviewed dozens of different premium financed life insurance programs. I've held off on writing an article on this topic because I hadn't found a program I liked or thought was consumer friendly. The programs I've reviewed did not do enough to mitigate a client's long-term risks as they pertained to the uncertainty of long-term interest rates and potential crediting rates on the cash-value growth inside the policies. Additionally, the programs did not work well unless the clients were over the age of 65 or so.

However, I've recently concluded my research on a unique premium financed program and due to the positive results of my research, I thought it was time now to write about this subject.

**Traditional premium finance**

Stated as simply as possible, premium finance is a program in which a client will borrow money to purchase a large life insurance policy.

The mechanics of premium financed life are fairly simple. The client borrows X amount of money each year (usually for a limited time), and the money is poured into a cash value life insurance policy. The client is liable for the loan (recourse) with the life policy and other client assets as *collateral*. The client typically does not make any actual interest payments on the loan unless the cash-value of the life insurance policy drops below a specific amount.

In plain English, if the cash value of the life insurance policy stays high, the lender is protected and is willing to wait until the death of the client to be repaid (which is done from the death benefit). If the cash value dips below a certain predetermined amount, the client must then make payments on the loan (interest and potentially, principal payments) from other assets.

Many programs are set up so the client must provide the lender with other "liquid" collateral for the loan besides the cash-value life insurance policy. What collateral? Usually stocks and mutual funds. Why? Because many programs are set up to allow the lender to "call the loan" and sell the stocks/mutual funds. The client consents to this when signing the initial paperwork.

That's one reason I don't like most premium financed programs. Many require the client to have "liquid" wealth and allow the lender to have access to that wealth per the lending agreement, where such assets could be sold without further client consent.

Some programs require interest to be paid after five to 10 years (it is not optional to let the interest continue to accrue). Such a program is not client-friendly in my opinion.

Side note: Some of you have heard of SOLI (self-owned life insurance) in which a company

will sell such a program to a client on the theory that the policy will be sold to a life settlement company in 24 months. Many of these programs are non-recourse and the official stance of the Wealth Preservation Institute is that such programs will not be around long and are against public policy. That is *not* what I will discuss in this article — I will discuss traditional, full-recourse premium financed life.

### **What about clients who are real estate rich and cash poor?**

I really struggled to find a program that would help an illiquid client in the premium finance community.

### **A “better” program**

This strategy offers the highest probability for success over any other program I have seen. I will call this program “PF,” and represent it as a viable lifetime premium finance program for clients who qualify and who have a legitimate need for long-term life insurance coverage. This is not a short-term, high-interest, non-recourse loan scheme whose only purpose is to sell the policy for a profit after a few short years. PF is a long-term, sustainable, recourse loan structure that requires the owner to assign minimal collateral to secure premium loans for large insurance policies.

PF is unique in that it is designed to provide large amounts of permanent, premium financed life insurance for high-net-worth individuals and their trusts (minimum net worth of \$10 million) with a high probability there will be no out-of-pocket cost to the policy owner.

The life insurance policy is aggressively funded to build immediate and rapid-growth cash value, which is used in part to satisfy the collateral requirements for the loan. Although some independent collateral is required to initiate the loan process for the early policy years, eventually the cash value should become the sole source of collateral for the loan. At that point, assigned outside collateral is released.

Most traditional premium finance programs use slow-and-steady cash building policies. The PF program is different in that it uses indexed equity life insurance and the policy is funded at or near the MEC minimum. The policy is set up with an increasing loan feature to cover the accrued loan balance each year.

What’s most important about the PF program is the exit strategy. All plans have loan exit strategies; taking place either during the insured’s lifetime or automatically at the insured’s death. The loan repayment is not dependent on cash value performance. Unlike most other competing programs, the policy only has to be in force for the loan to be paid off.

With PF, a trust (ILIT or IDGT) with borrowing provisions is utilized. The trust purchases a specific life insurance policy on the life of the client. The face amount is sufficient to pay estimated estate taxes, fund key-man or business buy-sell agreements, make a large endowment to a charity, or strengthen a family trust or foundation. The lender agrees to fund the premiums and the client may accrue or “roll up” the interest for a fixed term — 15 years, for instance. At the end of each loan term, a renewal loan may be obtained, subject to new

loan underwriting. The beneficiaries of the trust receive the net death benefit (gross insurance death benefit minus accrued loan balance), which is designed to be — at least — the initially requested death benefit.

### **Unique benefits of PF**

1. A differentiated premium financed life insurance structure in which loan principal and interest is repaid to the lender regardless of policy cash values (provided the policy is in force) at the time of death. The loan costs, interest and principal are rolled-up into the loan from year to year, until the loan is retired or until the death of the insured. As far I know, U.S. banks cannot offer these “non-performing” loans.
2. Business logic appeal: This strategy creates the opportunity to use financial leverage, and continue to earn a return on collateralized assets (whose profits can be utilized later) that otherwise would be used to pay current insurance premiums and gift taxes.
3. The annual death benefit increases to provide enough total protection to pay the beneficiaries the original desired death benefit after the loan is retired.
4. Lending relationships that offer longer-term lending with up to 15-year renewable loans and lower interest rates (with fixed margins over LIBOR) when compared to all U.S. banks and most international banks. The lending rates with the PF program are significantly less than U.S.-based programs.
5. Collateralized/assigned assets are left under the client’s management and control. The lender does not require that it take over the management of assets used for collateral.
6. If structured properly, a client can use the PF program and pledge only real estate (versus stocks and mutual funds) as collateral. Additionally, no personal guarantee is required from the lenders. Only assigned assets are used as collateral.
7. The plan can be structured to work for clients who are over the age of 40 versus most programs which only work for the “older” client.

### **PF example**

Tom and Mary, ages 50 and 49, respectively, have an estate valued at \$30 million and would like to acquire a \$20-million life insurance policy to benefit their only son. The annual premium cost is \$221,000 to Tom’s age 100. Tom could gift the premiums to an ILIT, wherein another \$89,000 gift tax would be added to the annual cost, making the total annual cost \$310,000. If Tom lives to age 100, his total outlay would be \$15.5 million, not including “lost opportunity cost” on investment assets he would have to redeem.

Tom and Mary have three choices:

1. Do not buy insurance (which would cost an estimated \$20 million)

2. Pay out of pocket (estimated cost — \$15.5 million.)
3. Proposed PF solution (anticipated out-of-pocket cost — \$0)

Peak at risk equals collateral \$1.83 million and peak assigned collateral at \$2.31 million.

To use PF, Tom and Mary will assign assets as collateral to receive the premium loans. The “at-risk” collateral (the net dollars at risk if the loan were to go into default) is defined as the difference between the cash surrender value (CSV) in the policy and the bank loan balance. The at-risk collateral for each year is projected to be:

- Yr. 1 = \$1.35 million
- Yr. 2 = \$1.36 million
- Yr. 3 = \$1.51 million
- Yr. 4 = \$1.66 million
- Yr. 5 = \$1.79 million
- Yr. 6 = \$1.83 million
- Yr. 7 = \$1.77 million
- Yr. 8 = \$1.65 million
- Yr. 9 = \$1.46 million
- Yr. 10 = \$1.04 million
- Yr. 11 = \$496 thousand
- Yr. 12 = \$0

Based on program models, after year 11 Tom and Mary will have no collateral “at risk” and could walk away from the bank loan and assign the policy to the bank in satisfaction of the debt. This would make no sense whatsoever, as the benefits of this strategy will increase dramatically moving forward.

By year 19, the effects of a “positive arbitrage” should have created a situation in which there is enough cash value to do two things: 1) Pay off the cumulative bank loan balance by way of a zero-interest policy loan, and 2) leave enough cash value in the policy to carry coverage to age 100 without the need of further premiums. As cash values continue to grow, the policy face amount will also grow. At Tom’s age 75 the projected face amount is \$27.5 million; at his age 80, it is \$39.7 million; age 85 is \$59.6 million; age 90 is \$90.9 million, etc.

## **Summary**

As you know, when creating short articles, there is only so much that can be discussed (especially on a topic like premium financed life insurance, which has many moving parts). In short, the PF program is unique in the type of loans that are used, the type of life insurance policies that are used and the collateralization of the loan. The program is much more client-friendly than any other I’ve seen out there.