FAQ's Regarding 3rd Party Premium Financing:
Is it Free Insurance?

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Over $2B of life insurance premium is funded annually with other people's money through various 3rd party premium-financing arrangements. This article addresses some of the most Frequently Asked Questions regarding the premium financing concept.

1. When is premium financing normally used? To acquire large tax-free life insurance policies without liquidating other investments. To increase returns using debt leverage. To fund trusts without gift tax. To protect current net worth. To continue business development. To enhance charitable giving.

2. What is used to collateralize the loan? Usually and primarily, the cash surrender value of the policy. Your existing investment portfolio, other assets, or letter of credit can provide the balance.


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3. What interest rate will be charged for my loan? Rates depend on the index used, loan terms, and negotiation. Best rates and terms are often obtained through working with your existing financial institution, allowing them to maintain all assets under management, or an institution wanting to establish a relationship with you.

4. What determines the base rate? The Prime Rate, LIBOR, or a particular currency resulting from a multi-index search. Some high net worth clients obtain low interest rate funding with Variable Rate Demand Obligations (VRDO) in a note or bond form.

5. What policies are best for outside financing? Indexed Universal Life contracts with high early cash values; documented low cost of insurance charges, transparency, and potential to earn higher returns than whole life and universal life policies.

6. Is there a guideline rate assuring success? No, but in our experience, these plans work best when the spread between policy crediting rates and loan rates are projected at least 150 to 300 basis points.

7. Are Variable Life policies good for 3rd party financing? No. Only 50% of cash value may be used as collateral. The downside risk of negative earnings dramatically increases exposure to post additional collateral.

8. What's one primary factor to determine the maximum loan to consider? The amount of external capital you are willing to post in a worst-case scenario.

9. What's a safe amount of life insurance to purchase with outside financing? The amount that you could purchase without premium financing.

10. What "Exit Strategy" is used to repay the loan? Several examples include: Design the policy to provide excess cash value to repay the loan. Repay the loan with other funds allowing the cash value to maximize the policy's benefits. Repay the loan when a particular asset is sold. Or, in the event of your death, a portion of the tax-free death benefit will repay your loan.

11. Is waiting until I die a good Exit Strategy? No. Most loans are repaid within 10 to 15 years minimizing the risk that loan interest rates will spike over the cash value growth rate.

12. What if my life expectancy is less than 15 years? Even if you are insurable, costs of insurance will create a drag on earnings that diminishes the leverage available through premium financing.

13. Is selling my policy a viable Exit Strategy? No. First, if you buy a policy with the intent to sell it, you may be committing fraud. Second, if you're in good health, the sale proceeds will not pay off your loan. Third, non-recourse financing with intent to sell the policy after two years generally has been determined unethical and illegal.

14. What happens to my policy after repaying the outside loan? It continues, usually in an estate tax-free trust, until the income tax-free death benefit is paid.

15. How would you evaluate the benefit of a premium financing transaction? We recommend an internal rate of return analysis to determine the IRR on the death benefit at the insured's life expectancy. It could be in the double-digit range because you expect to minimize your outlay with the outside loan.

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experience, and working relationships with known and effective intervention counselors, recovery programs, therapists, psychiatrists, medical doctors, and, yes, sometimes criminal defense attorneys, can create mechanisms through your estate plan to grow, mature and develop a child into a whole, joyful and self-actualized adult.

In my opinion, "bad apples" were never the exception but were always the rule; we just didn't talk about it. In my life and my estate planning practice, I have observed that even the best parenting can yield unexpected results; it is a consequence of the chaotic, fast-paced and hectic world in which we live – no one goes through the crucible of life without bumps and bruises, and some come through with lacerations and broken legs. Well-meaning parents are asking their wounded children to run the race of life prior to the mending of those "broken legs." Work with a trusted advisor whose hope, like yours, is to see your child walk, not one who views his role as simply saying "no" only as needed to prevent a death or other disturbance to the estate, for this is doubtfully the standard against which you hoped your child's life would be measured.

An estate plan, like cash, is simply a tool; it is a means, not the end. The work of preserving your legacy will be accomplished through the relationships you form. Your estate planning attorney must possess the legal savvy, tax knowledge and technical know-how to draft a legally effective estate plan; however, that only gets him through the door. To have a seat at the table, your attorney must demonstrate compassion, appreciation and an understanding of your family's unique emotional needs, and your family's mission and vision. Your trusted advisor should be committed to the preservation of your true legacy, your children; the recipients of your genetic make-up and the wisdom passed down through the prior generations that gave you life.

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16. Will I have to pay the loan interest every year? It may be the best option. Most companies require you to pay at least the first year's interest in cash to ensure some "skin is in the game". If you roll future interest payments into your loan, the policy may lapse if you attempt repaying both principal and interest with cash values.

17. How would you describe the ideal client for premium financing? Age 55 to 75 with net worth of at least $20 million, insurable at Preferred rates, sufficient liquidity to establish a Risk Mitigation Fund, and excellent professional advisors. Most insurance companies require minimum net worth of $5,000,000. Most lenders want the total loan to be at least $1,000,000.

18. What's your best advice if I want to dig deeper? Work with a firm that has significant expertise and involve your other professional advisors to ensure an informed decision is made.

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In combining the ongoing marketplace review of an insured's risk profile with an up-to-date road map of carrier product offerings and pricing, a life insurance portfolio can be actively managed to ensure that the current portfolio is consistently the best available. As with any proposed change to any policy, significant due diligence and research should be conducted by your advisors on the suitability of any alteration or exchange. All parties should be aware of the impact of a contractual change. An active management approach that monitors the current life insurance marketplace will allow you and your advisors to be aware of any potential improvement, should you decide to pursue it. At a minimum, no opportunity will be missed.