

## When Does Premium Financing Make Sense?

- In many cases, premium financing does not make sense:
  - Insured person has adequate cash flow to pay premiums.
  - Insured person does not face difficult choices concerning allocation of discretionary cash flow.
  - Insured person lacks alternative uses of capital with much higher rates of return than can be expected to accumulate within a life insurance policy.
- Ideal case for premium financing combines these elements:
  - Insured person of any age.
  - High net worth.
  - Long-term need for permanent insurance.
  - Short-term or transitional constraints on use of discretionary cash flow
- Another possibly valid scenario has these elements:
  - Age at least 60 years old.
  - High net worth.
  - Collateral available to fund a low interest cost, secured loan.
  - Financing lined up for the remaining lifetime of the insured person.
- Risks of premium financing:
  - Accumulation of interest cuts into economic value of death benefit.
  - Liquidity may not be available at time of expected loan repayment.
  - As always, tax matters deserve special discussion with your accountant or tax advisor.
- Market considerations and trends
  - “Non-recourse premium financing” is defined as financing in which the borrower makes no personal guarantee and posts no collateral (other than the insurance policy being financed) as backing for the Note; instead, the lender looks to the policy value alone as collateral.
  - Non-recourse financing minimizes the financial risk of the borrower, but the interest rate charged will be *substantially* higher than if the borrower gives a personal guarantee. This is because the lender may face greater risk without such personal backing. If the borrower is willing to give a recourse note, and/or post financial collateral to back a loan, there is much greater flexibility in choice of insurance companies to make application to.
  - We see interest and continued activity in non-recourse premium financing. But most insurance companies have taken a stand against it, and it is increasingly difficult to obtain.
  - “Collateralized financing” of life insurance premiums requires that the policy owner post financial collateral to support the gap at any time between policy cash value and loan amount due at that time.
    - Some lenders may accept a so-called “control agreement” over a securities account. Under such an agreement, administered by a securities firm, the borrower is normally free to trade securities but cannot withdraw them.



of Regulation D of the federal securities law. For an individual to be an accredited investor, that person must have net worth of at least \$1 million or annual income of at least \$200,000 (or joint income with a spouse exceeding \$300,000). See <http://www.sec.gov/answers/accred.htm>. Such accredited investors must sign a statement affirming their status as such, of which we can provide a sample.

■ Eligibility

- Non-recourse premium financing is typically limited to seniors (ages 70 and above).
- Recourse and collateralized lending is not limited by age, but rather by adequacy of financial backing.
- Borrowers must demonstrate wealth/income, as discussed above under “Regulatory Considerations.”
- Prospective borrowers must be informed of their rights under HIPAA, the federal health care privacy statute, and sign releases under that Act.