YOUR QUESTIONS ANSWERED ABOUT PREMIUM FINANCING

What life insurance products can be used in premium financing?

The products used in premium financing arrangements are Universal Life, Indexed Universal Life and Whole Life. The policy can be a Single Life or Survivorship policy. Variable Universal Life and Term products are not allowed for premium financing.

Do all life insurance companies allow their policies to be financed?

No, not all carriers will allow your clients to finance a policy. You will need to check with the life insurance carrier or your Tellus Advanced Sales Director for participating life insurance carriers.

Do life insurance companies accept any premium financing lender?

No, the lender must be pre-approved by the life insurance carrier prior to entering into a premium financing contract or your clients may run the risk of the life insurance carrier rescinding the contract.

Who is responsible for monitoring the collateral required for the loan?

The premium financing lender will analyze the collateral needed on an annual basis. Some lenders may charge a maintenance fee for an analysis on the collateral requirements.

Who is responsible for monitoring the performance of the life insurance policy?

Premium financing is not a "set it and forget it" sale. The life insurance producer and the clients should evaluate the policy every year to make sure the policy is performing as sold. If the policy is not performing as sold, the clients and the producer may want to have a discussion on how to handle the shortfall of cash. Successful execution of a premium financing transaction requires proper long-term management of both the financing component and the insurance policy itself and should be monitored very closely and frequently.

What is the crossover point?

When you have a client who is considering premium financing, he or she should always compare a financed situation to a non-financed situation. The crossover point is when the loan interest payments start to exceed a non-financed premium outlay. This is when a premium financing transaction starts to become more expensive over a non-financed premium transaction and the premium finance strategy starts to lose its arbitrage.

Why do you use return of premium rider or increasing death benefit for premium financing cases?

In premium financing, the lender has to be paid back and the heirs will receive the residual death benefit after the lender has been paid off. The return of premium rider will net the specified death benefit to the heirs. If the clients are using increasing death benefit, there will be some years the death benefit to the heirs will be less until the death benefit increases enough to cover the accumulated loan. Keep in mind that the return of premium and the increasing death benefit added to a life insurance contract will inflate the cost of insurance charges for the additional death benefit over a level death benefit non-financed outlay.

Why is an impaired risk not a good candidate for premium financing?

In premium financing, the return of premium rider (or increasing death benefit) already inflates the cost of insurance over a non-financed outlay. If you add a table rating to the mix, this further increases the cost of insurance in the life insurance policy. The premium financing concept loses its arbitrage much earlier over a non-table rated case and it may not look as attractive to the prospective buyer.

Can a modified endowment contract (MEC) be used in a financing scenario?

There are very limited lenders and life insurance carriers that will allow a MEC contract to be financed. Lifetime distributions from a MEC policy are taxed differently than a non-MEC policy. In a non-MEC policy, you can take a withdrawal from the policy as your return of premium (basis) coming out first, then switch to a non-taxable loan. If your client's policy is a MEC policy, any distribution from the policy (withdrawal or loan) will be considered as taxable gains coming out first, then a return of premium (basis) thereafter. The gains will be taxed as ordinary income. Additionally, if the client is under 59 1/2 years old, he or she could also be subject to an additional 10% federal income tax penalty.

If your client's exit strategy is to take a withdrawal from the policy to repay the loan and the policy is a MEC, he or she will have to pay the tax on the distribution up to the gain in the policy—an additional cost to the client.

How long can my client capitalize on interest payments?

It will depend on the lender and the life insurance carrier. Most programs will not allow your clients to capitalize on loan interest for more than five years. Keep in mind that deferring payment of interest on your client's loan will quickly increase the amount of that loan and therefore, will reduce the net death benefit if he or she does not create a plan for repaying the loan.

What are common exit strategies for premium financing?

The exit strategy will depend on the client's personal situation. The most popular exit strategy for the average client is taking a withdrawal from the policy to repay the loan. Death can be an exit strategy for older clients as long as they do not run the risk of longevity. Below is a list of possible exit strategies your client can use to exit a premium financing transaction:

- Withdrawal from the policy
- Death
- Creating a side fund
- Selling client's personal asset(s)
- Grantor Retained Annuity Trust (GRAT)
- Installment Sale to Intentionally Defective Irrevocable Trust (IDIT)
- Charitable Lead Trust (CLT)
- Grantor Loan to ILIT

What types of collateral will lenders accept?

The lender may require your client to post collateral if the policy's cash value is less than the accumulated loan. Posting real estate as collateral can be problematic with some lenders due to its lack of liquidity and/or marketability for most lenders. Some types of marketable securities may be discounted due to the volatility of this type of collateral. Common collateral most lenders will accept include:

- A letter of credit (LOC)
- An insurance policy
- Cash equivalents
- Marketable securities (valued at the lender's discretion)

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