GB FINANCIAL GROUP

Financed Life Insurance: The Risks

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Risks

We distinguish between five different risk categories, which are:

INTEREST RATE VOLATILITY RISK

Since the interest due on the premium finance loan is tied to an index, such as LIBOR or Prime, the total interest charge, in an increasing interest rate environment, will rise as well. If the policy owner cannot afford to make the interest payments or post the additional collateral, then they stand the risk to default on their loan, and as a consequence lose their insurance.

RENEWAL RISK

The lender has the right to call the loan at the end of the term. Virtually all premium finance loans have a duration that is shorter than the life of the policy.

CARRIER CREDIT RATING RISK

Financing terms are sensitive to the credit rating of the carrier that has issued the financed policy. Carrier downgrades may result in the lender choosing to not lend additional premiums and/or call the loan.

CREDITING RATE RISK

Carriers determine the crediting rate of in-force blocks of business based on the investment results of their fixed-income general account, or, in the case of indexed-linked universal life policies, the crediting rate is driven by the performance of the underlying index/indices. Current crediting rates are not guaranteed. As such, any illustrated arbitrage in interest rates between the policy crediting rate and the loan interest rate may not exist in the future.

COLLATERAL RISK

Most premium financing arrangements that are designed to provide liquidity to the client at death are 100% collateralized. In most cases, the client must either post a letter of credit or hard assets to satisfy collateral in addition to the policy. Collateral requirements may vary with economic conditions and could force the client to liquidate positions in order to post collateral. Furthermore, a decrease in the value of collateralized assets (such as real estate or securities) may force additional collateral.

All of the risks associated with the structure and the transaction are manageable risks and can be coped with during the life of the transaction. Certain risk elements can however be significantly mitigated during the design stages of the process and reduce the likelihood or the severity of these risks after the solution has been implemented. The experience of the company that structures these transactions is paramount in addressing these risks.