

Financed Life Insurance: The Transaction Structure

Produced By:
Bracknell Baker, Managing Partner
Caleb Baker, Managing Partner

The Transaction Structure

A premium finance transaction has several parties involved who each play their respective part in creating a successful solution. It starts with the insured, who has been working with his/her advisors to create a comprehensive estate plan. Life insurance often plays a critical part in the overall estate plan, as it is the only asset that liquefies tax-free at the passing away of the insured. The created liquidity is customarily used to pay estate taxes or to purchase illiquid assets out of an estate.

For the purposes of the premium finance transaction, the insured establishes an ILIT. This trust applies for life insurance on the life of its grantor/settlor with a top-rated insurance company. This should be done through a firm that specializes in designing these types of insurance-based strategies and has an in-depth knowledge of the various insurance contracts offered by the life insurance companies. In addition to this expertise, the company should have the expertise and multiple lending options from selected institutions that have an understanding of premium financed life insurance.

The company should be able to combine all of these factors to design a comprehensive and well-balanced premium finance transaction that is specifically tailored to each individual client and is geared to perform to the client's stated objectives over the long term.

The company subsequently guides the client through both the life insurance underwriting process, as well as the lender's financial underwriting process. When both an insurance offer and a lending offer have been obtained, the company facilitates the documentation process and assists in completing the transaction. In addition the company works to actively manage the solution for long-term success and make sure the annual renewal and review process is a seamless one.

The flow chart in the beginning of the paper walks through the structure of the transaction from start to finish and addresses the various parties and moving parts.

It is worthwhile to mention the four cornerstones of the foundation of any successful premium finance structure:

1. The ILIT is the owner of the policy, but also remains the borrower of record, thereby eliminating the gift tax on all premiums and interest that is borrowed. From the lender's perspective this removes any credit and bankruptcy risk on the insured, while from the insured's perspective, the loan does not impede his or her borrowing capacity.
2. The financing package is designed specifically for this type of transaction and thus incorporates important features, like a low cost of the borrowing and the absence of pre-payment penalties on loan refinancing or repayment at anytime. These characteristics, amongst others, allow flexibility for effective long-term management.

3. The insurance policies used are designed to provide a policy structure and features that will perform for a client's lifetime, with base guarantees and upside potential allowing for the loan to be re-paid at death and the tax-free benefit to remain intact.
4. The insured's understanding and ability/desire to make some payments of interest or premium and post collateral are critical to the long-term success.

As mentioned previously it is important that the firm designing these solutions is also intimately involved in implementing the solution. From the insurance underwriting and financial/credit underwriting, the design, structuring, annual renewal process, and the active management of the solution it is critical for clients to work with an experienced firm. The lender who is making these loans should be committed to the lending structure and work with a loan servicer and processor who understands the uniqueness of this type of loan.