

Financing Life Insurance: Efficient Generation of Estate Liquidity

A white paper exploring the need, the structure, the marketplace, the efficiency and the risks of financed life insurance.

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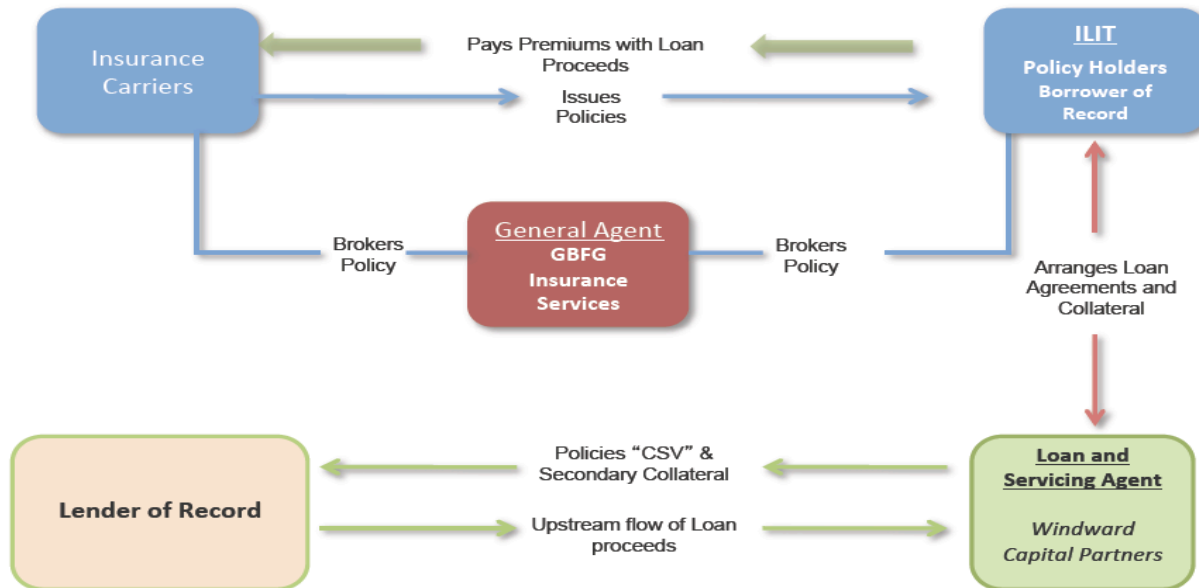
Executive Summary

Traditional premium financed life insurance is a structure that enables affluent clients to acquire the insurance benefits they need, without impacting current cash flow and the possible cost of gift tax associated with purchasing insurance. This fully collateralized form of lending, whereby the borrower, typically an Irrevocable Life Insurance Trust (“ILIT”), borrows the life insurance premiums necessary to pay for a permanent life insurance policy, is specifically structured to complement a sophisticated estate plan. The ILIT is the borrower of record for the loan, which, from the lender’s perspective removes any credit and bankruptcy risk on the insured. From the insured’s perspective, the loan does not impede his or her borrowing capacity.

The loan will be collateralized primarily by the policy’s cash surrender value and, if and when necessary, additional collateral in the form of cash, marketable securities or a letter of credit, posted, by the insured or corporation, on behalf of the ILIT.

The primary reasons for the insured to enter into a premium finance transaction instead of paying cash for the policy are: (a) it allows current investments and cash flow to remain intact; (b) to optimize estate planning and succession planning; and (c) to reduce and in some cases eliminate the gift tax liability that can be created when using current cash flow for life insurance.

Successful execution requires proper structuring and long-term management of both the financing component and the insurance policy itself. The objective of the structure is to provide the client with a lifetime solution, whereby the loan will be repaid from policy proceeds at the client’s passing. Long-term success requires a collaborative effort whereby the firm designing, underwriting, implementing and managing the solution for the client works hand and hand with the insurance company issuing the policy and the lender making the loan. The flow chart below depicts the transaction that forms the basis of this paper.



**Premise:** Life Insurance is the only financial product in the world guaranteed to liquefy tax-free at death.

**Who:** Affluent individuals with a net-worth typically in excess of \$15million and whose estates have liquidity needs at their death, most often to pay federal and state death taxes or to assist with business succession.

**Why:** The acquisition of life insurance requires liquidity to meet the significant premiums, which can preclude an individual from obtaining the life insurance coverage needed. In addition, because of the tax-free nature of the life insurance benefit, the premiums used to fund the policy are considered a gift to the beneficiaries of the policy and thus exposed to gift tax. These tax implications can greatly reduce the long-term benefit of the policy and increase the required liquidity needed to fund the solution.

## **Background**

A life insurance policy, when structured correctly, provides three valuable benefits: (1) a known death benefit; (2) tax-free treatment of that benefit; and (3) peace of mind for funding the estate plan to provide the liquidity needed following the death of an affluent insured. While the specific need for liquidity at death varies, the most common purposes are (a) funding of an estate tax bill and (b) liquidity needed to assist in business succession (e.g. to fund a buy-sell type arrangement or to retire debt obligations).

The tax-free growth of the internal policy values and tax-free treatment of the death benefit proceeds of an insurance policy are some of the greatest benefits a policy provides. To protect the tax-free treatment, the insurance policy must be owned outside of the insured's estate. The most common form of ownership to meet this criterion is the Irrevocable Life Insurance Trust. An ILIT removes all ownership and direct control of the policy from the grantor, who in most cases is the insured. A further benefit of the trust is the effective elimination of possible gift tax implications caused by any funded premiums because the trust will borrow the funds directly as the owner of the insurance policy.

This form of ownership of an insurance policy and removing it from the estate is one of the oldest components of a basic estate plan. Life insurance provides a social "welfare" benefit. It provides for dependents and thus removes the risk of those dependents experiencing life-altering consequences after the passing of the family steward. The proceeds are tax free to the beneficiaries (no income, capital gain or other type of tax is levied); the proceeds are also not included in the estate of the insured. However the payment of the premiums by the insured on behalf of the trust is considered to be a present gift to the beneficiaries, thus those payments are exposed to the federal gift tax. That tax liability can be a significant burden and erode the long-term economic benefit the policy will provide. By having the trust finance the acquisition of the insurance policy, no present gift is made to the beneficiaries and thus the gift tax is effectively eliminated.

Individuals with a net-worth below that of those qualifying for this type of solution will usually purchase term insurance or some form of permanent life insurance, with the intent to fund income replacement, college expenses, or to pay-off a mortgage in the event of an untimely death. Permanent forms of life insurance can also be used as cash accumulation vehicles. The above two referenced types and uses of life insurance fall outside the scope of this paper and will not be further discussed.

## **The Market Place** (*Lending and Insurance*)

### Lending

Although no exact data is available about the total market size of financed life insurance policies, industry participants seem to agree that in the past decade several billion dollars of life insurance premium has been financed. The landscape today is filled mostly with financial institutions that make premium finance loans available as an asset gathering/client prospecting tool for their private banking businesses. There have been a number of private banking divisions from some of the largest institutions who have provided financing of insurance policies as an additional service for clients. Independent premium finance lenders who exclusively focus on making traditional premium finance loans have disappeared since the financial crisis of 2008 as they experienced great difficulty in attracting long term stable capital. As a lending source, retail premium finance lenders will provide the greatest service for the client. The market demand for traditional premium finance loans is unabatedly robust.

The biggest challenge most borrowers face is the lack of long-term exclusively premium-finance-focused lenders. It is particularly difficult to find a lender who has outsourced the loan processing and servicing activities to a company whose sole business it is to provide these services for traditional premium finance loans. The advantages to the client of such a combination are numerous. For instance, a lender that is looking for ancillary business may be unwilling to extend credit should the client not engage in other services. In addition, it would require the client to disrupt existing relationships. Also, lenders who are focused on asset gathering will typically lack the necessary understanding of insurance and the intricacies of the symbiotic relationship between the lending and the insurance components, thereby potentially jeopardizing the long-term success of the structure.

In addition to the domestic US market place, traditional life insurance premium finance has also seen international activity. For many years, the Asian market has been successfully penetrated and significant volumes of traditional premium finance loans have been made to the offshore vehicles of Asian entrepreneurs. In addition to internationally focused Asian clients, there is a detectable amount of international insurance premium finance activity developing in Latin America as well as The Middle East.

### INSURANCE

Life insurance companies view traditional premium finance as an “advanced concept” that is important to provide to their sales force to enable affluent clients to implement the strategy with the carrier’s products. Many, if not all, recognize the sales enhancement opportunity premium finance offers by providing clients flexible funding strategies with regard to the

acquisition of large life insurance policies. The benefit of a life insurance policy is self-evident, but it is one of the only assets an individual will purchase that they will not benefit from personally. For years insurance companies have struggled to bridge the gap between the client's needs during their life and the benefit their product will provide to the client's estate, family and business.

It is imperative that life insurance companies whose products are to be financed approve the premium finance lender's lending parameters and business practices. Without the insurance carriers' written consent of the structure, the insurance carriers will not acknowledge that the policy can be pledged to the lender of the financed life insurance policies.

In addition, the insurance products offered by the various US insurance companies need to be designed to successfully work in the premium finance structure. Not all life insurance products can provide a viable solution and it is important for the long-term success that the products used function and perform well in the overall structure. There are three critical product features required for long-term success:

1. The ability to attain growing, long-term positive cash values, since these cash values are used as the primary collateral in the transaction;
2. The ability for the death benefit to increase on an annual basis, which provides a more level economic benefit when the loan is repaid from the death benefit. The increasing death benefit can be guaranteed or based on policy performance;
3. The ability to have flexibility in the timing of premium payments in the event a funding change needs to be made.

## **Financing Life Insurance**

The most salient advantages of the financing of life insurance are the elimination of the otherwise required and often significant out-of-pocket annual premiums. The opportunity cost for insureds (paying for an insurance policy vs. applying the money to their business endeavors) is frequently a deterrent for acquiring the necessary insurance coverage.

A premium finance loan also allows for a bundled payment to different life insurance companies in situations where it is advisable for the client to spread the insurance carrier risk over several insurance companies. The loan facilitates a continued ease of execution.

The primary struggle for many clients is the delicate balance between the needs they have during their lives: be it living expenses, objectives for business growth or other long-term plans, versus the needs their estate will have upon their passing. For many clients often a predominant component of their net-worth is invested in non-marketable securities or closely held businesses. The existing cash flows are typically pre-allocated and leave little or no room for significant cash outlays for insurance premiums. Financing the premiums allows for a continuation of the status quo, while obtaining the required liquidity needed for execution of an estate plan without creating gift tax implications.

## **Designing an Insurance based Solution**

When life insurance is part of an estate plan or used to create liquidity for other purposes following the death of an affluent individual, a number of questions need to be addressed during the design and implementation of the insurance-based solution:

1. Determining the net economic benefit.

What is the true need? How much tax-free liquidity is required at the client's death to fund the identified obligations? What will the ultimate cost of acquiring the desired benefit be in relation to the liquidity needed? What are the possible tax implications and the opportunity cost? Many affluent clients tend to have significant illiquid assets, which perform better remaining in the form they are in, then being monetized to pay insurance premiums.

2. What is the health of the insured? Life insurance is medically underwritten and delaying the acquisition of the needed benefit until the insured reaches a certain age will greatly increase the cost of insurance. In certain cases, the increased cost is not prohibitive, but in the majority of situations the feasibility of the transaction increases exponentially when entered into by an insured at a relatively younger age. As mentioned earlier, policies today can be structured with an increasing death benefit. Over the lifetime of the client this can assist in keeping the net benefit synchronized with the growth of the asset value in the estate.

3. How will the policy be funded? This is a critical subject that often doesn't get the attention it warrants. Many insurance professionals do not have a good grasp of the entire estate plan nor the client's asset composition. A properly designed and executed life insurance plan must be based on a comprehensive and thorough knowledge of all facets of a client's life. Life insurance has the embedded flexibility to be customized for almost any situation from the standpoint of both the ultimate benefit and the funding structure. The premium flow needs to be designed to accommodate the client's ability to fund and be mindful of the possible gift tax implications.

The answers to the identified questions above are often the reason why many affluent individuals do not acquire the insurance benefit they need. The challenge lies in creating a solution that will bridge the needs of a client during his or her life with the needs of their estate at the time of their passing away. The traditional premium finance solution requires minimal liquidity to fund the life insurance policy, while gift taxes are minimized and/or eliminated and it provides the client with the insurance coverage needed. The solution furthermore allows the client an unrestricted continuation of assets and estate growth. The long-term benefits are: the estate to be settled in the most efficient manner possible and, most importantly, the retention of maximum value for the beneficiaries.

## **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.



## **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.

### A Historical Comparison of the Average Spread Between Borrowing Rates and Product Performance Rates

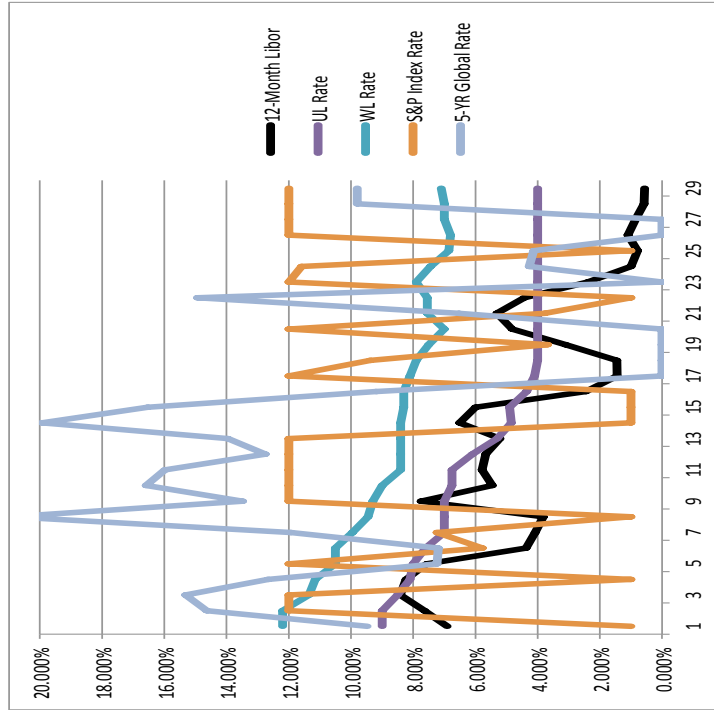
While historical rates are no indicator of future rates or performance, looking back and examining the relationship between borrowing rates and product performance rates can help put the relationship between rates into context.

The formula for average spread needed for premium financed success, as well as an important discussion on internal COIs, will be discussed in the following section, but historically, we can see that there has always been a net positive spread with the rates of policies out-performing borrowing costs over time. Further, certain products, specifically fixed UL products and Whole Life products, can be observed clearly mirroring the evolution of borrowing rates over the decades.

Since 1986, the spread between 12-month Libor (the predominant borrowing rate used) and UL product performance was 1.33%. For an annual S&P Index product it was 3.65%. For a 5-year point-to-point global indexed product it was 4.95%. For a Whole Life product, it was 4.41%. Keep in mind the spread needed will vary based on the client's age, health, the product's internal cost structure, and any out of pocket contribution the client makes.

Historical Borrowing Rates Compared to Historical Policy Performance

Year	12-Month Libor		Carrier Crediting UL Rate	Carrier Dividend WL Rate	S&P Index Crediting Rate	5-YR Global Index Crediting Rate
	FedFunds	Prime				
1986	6.80%	8.33%	9.00%	12.20%	1.00%	9.48%
1987	6.66%	7.633%	9.00%	12.20%	12.00%	14.63%
1988	7.57%	8.414%	8.50%	11.35%	12.00%	15.32%
1989	9.21%	8.234%	8.10%	11.15%	1.00%	12.66%
1990	8.10%	7.563%	8.00%	10.50%	12.00%	7.24%
1991	5.69%	4.375%	7.60%	10.50%	5.78%	7.19%
1992	3.52%	4.078%	6.25%	9.95%	7.24%	11.93%
1993	3.02%	3.813%	6%	9.45%	1.00%	20.93%
1994	4.21%	7.750%	7.00%	9.30%	12.00%	13.48%
1995	5.83%	5.454%	8.83%	9.00%	12.00%	16.58%
1996	5.30%	5.789%	8.27%	8.40%	12.00%	15.98%
1997	5.46%	5.689%	8.44%	8.40%	12.00%	12.75%
1998	5.35%	5.213%	8.35%	8.40%	12.00%	13.96%
1999	4.97%	6.508%	8%	8.40%	1.00%	19.93%
2000	6.24%	5.997%	9.23%	8.30%	1.00%	16.54%
2001	3.88%	2.445%	6.91%	8.30%	1.00%	9.19%
2002	1.67%	1.447%	4.67%	8.10%	12.00%	0.00%
2003	1.13%	1.458%	4.12%	7.90%	9.38%	0.00%
2004	1.35%	3.100%	4.34%	7.50%	3.68%	0.00%
2005	3.22%	4.823%	6.19%	7.00%	12.00%	0.00%
2006	4.97%	5.314%	7.96%	7.55%	3.77%	6.52%
2007	5.02%	4.423%	8.05%	7.55%	1.00%	14.93%
2008	1.92%	2.385%	5.09%	7.90%	12.00%	0.00%
2009	0.16%	0.999%	3.25%	7.45%	11.59%	4.27%
2010	0.18%	0.784%	3.25%	6.85%	1.00%	4.13%
2011	0.10%	1.100%	3.25%	6.80%	12.00%	0.00%
2012	0.14%	0.848%	3.25%	7.00%	12.00%	0.00%
2013	0.11%	0.580%	3.25%	7.00%	12.00%	9.80%
2014	0.25%	0.562%	3.25%	7.10%	12.00%	9.80%
<b>Average</b>	<b>3.86%</b>	<b>4.26%</b>	<b>5.60%</b>	<b>8.67%</b>	<b>7.91%</b>	<b>9.22%</b>



**UL** Spread between Crediting Rate and Borrowing base rate: **1.33%**  
**Whole Life** Spread between Crediting Rate and Borrowing base rate: **4.41%**  
**S&P Index** Spread between Crediting Rate and Borrowing base rate: **3.65%**  
**5-Yr-Global** Spread between Crediting Rate and Borrowing base rate: **4.95%**

Note: The numbers presented above are based on historical performance; they are not a guarantee of future performance.

The Relationship Between Borrowing Cost, Policy Performance, and Internal COIs

At its simplest, the success of a premium-financed structure can be reduced to the formula:

$$[X(t) - (Y(t) + Z(a, h, p)) > \text{Savg}(Z(a, h, p))]$$

X = Policy Performance

Y = Cost of Borrowing

Z = Cost of Insurance as dictated by a, h, p

Savg = Average Spread Needed

a = Insured's Age

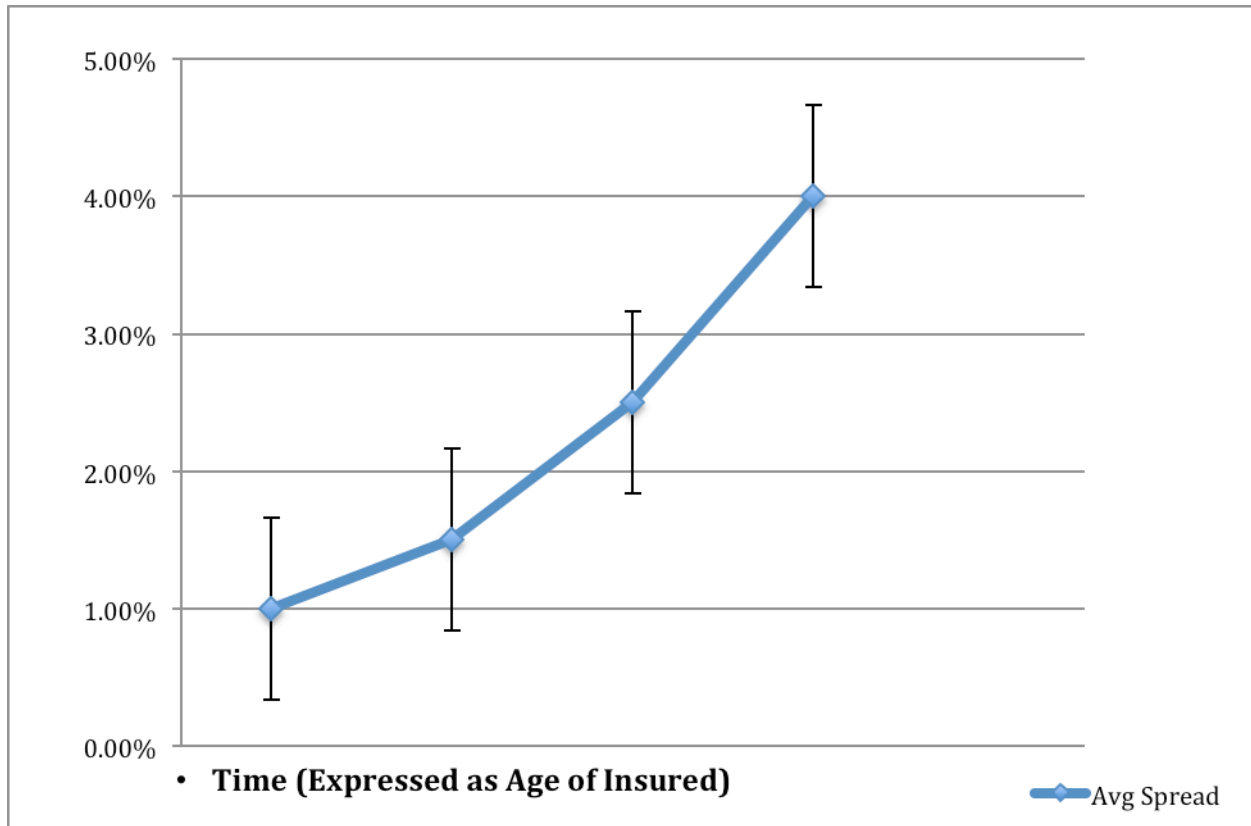
h = Insured's Health Rating

p = Product's Internal Costs

t = Time

Because the policy's death benefit is what will be used to payoff the loan amount, the structure's success depends on the arbitrage between the cost of acquisition and the value and growth of the policy itself. Because COIs increase as the insured ages, the average spread needed increases as well.

This equation is plotted graphically below where Y-Axis = Average Spread Needed, and X-Axis = Time (Expressed as age of Insured)



For this reason, the focus must be on what the average spread must be over the life of the policy to keep the transaction successful. Premium financing is a flexible transaction and the need for collateral will be impacted by the average spread, and while that is an important consideration, this paper will focus on solvency of the transaction, and therefore be focused on death benefit's relationship to the loan balance.

While the internal costs of insurance vary according to both product type (Universal Life or Whole Life) and insurance carrier, we can conclude that the minimum average spread needed is approximately 150 basis points. An increase in this spread will be directly correlated with an

increase in the insured's age, a decrease in the insured's medical underwriting rating, and increased product costs. A decrease of this spread can be directly correlated with a client contribution to the structure via partial premium payments or interest payments on the loan or by using a survivorship product, which has inherently, lower internal COIs.

While the following section will deal specifically with the mechanics of a client contribution, the fact is clear: the simplest way to reduce the average spread needed is to reduce the leverage the transaction, namely through a direct client contribution.

### Offsetting Risk Through Client Contribution

Risk can be mitigated through a client's financial contribution to the transaction. The client who chooses to deleverage the structure can do so by: (a) paying all or a part of the interest due on the loan (decision can be made annually); (b) paying all or part of the annual premium (decision can be made annually) and (c) by contributing the cash surrender of an existing life insurance policy. These options have several advantages. They reduce the embedded volatility in the structure, the net economic benefit can increase and the additional collateral that may need to be posted can be reduced.

The equity contribution by a client can be the most effective way to manage the inherent interest rate and policy performance risk. The equity from a client provides a cushion for the inevitable fluctuations in rates going forward. In addition the contribution will in most cases be a fraction of what the same benefit would have cost the client had they not financed the solution.

The firm that structures these solutions should have the ability to illustrate for a client what types of contributions will have an impact, how they will impact it in later years and most importantly should provide flexibility for contributions going forward in any given year.

### **Case Study:**

Example of a male age 55 will provide context to the narrative.

The client, a successful executive and a father of two young children knew he had a significant need for insurance, but had been put off by the significant liquid contribution necessary to acquire the amount needed. He had a small term policy, but was severely underinsured leaving both his family and his business vulnerable. GB Financial was brought in to provide a solution. GB Financial analyzed his current insurance and discussed the various options for providing the death benefit needed through a variety of insurance products.

A well versed investor, the client realized the opportunity cost gained by financing the insurance. Educating and working together with the client's current estate planning team, GB Financial put together a diversified financed life insurance structure, implemented it, and continues to manage it years later.

### Client Specifications:

- Age 55
- Estate \$25million
- Asset mix 65% illiquid, 30% liquid, 5% other

- Liquidity need at death \$9.5million
- Standard health

When designing a premium-financing scenario, it is important to have a good understanding of the client's needs, the client's asset mix and the overall estate plan. The initial design is then created by structuring a life insurance policy that meets the client's objectives. Careful consideration is also given to designing the specific lending structure so that the result allows for the most balanced relationship between the policy and the premium finance loan. The proposal that is then prepared for the client's review should run the transaction through multiple interest rate environments and illustrate the impact of changing rates. In addition, the client should be shown what the structure looks like if 5 years of interest is paid current and not accrued and what 10 years of interest being paid current looks like if not accrued. These various scenarios are a helpful tool for the client to understand the correlation between a small financial commitment and the long term viability of the transaction as well as the ability of the transaction to weather uncertain interest rate environments.

The following definitions of terms refer to the chart on the following page which shows the transaction as explained under the current cost of borrowing.

Premium Paid By Client: The amount of premium paid out of pocket by the client.

Premium Borrowed: The amount of premium borrowed annually by the Irrevocable Life Insurance Trust on behalf of the insured. This is paid to the insurance carrier each year for the number of years noted in the Economic Benefit Analysis.

Rate of Borrowing: Current cost of borrowing for specific year.

Interest Paid by Client: The amount of interest paid out of pocket by the client.

Interest Borrowed: The amount of interest borrowed annually by the Irrevocable Life Insurance Trust on behalf of the insured.

Cumulative Loan: Full amount borrowed by the Irrevocable Life Insurance Trust plus interest/fees since the inception of the policy.

Policy Collateral Value: The policy collateral value is the net equity of the policy. This is an end of year value calculated annually at the beginning of each calendar year allowing us to show you the how much cash is in the policy after yearly costs are taken out. This value is always shown with no performance being factored in for the upcoming year.

Collateral Required From Client: This is the difference between the cumulative loan and the policy collateral value. It is an amount the client needs to post above the policy itself. When



this number is zero, the cost of paying back the loan is less than the net equity of the policy, and the policy is the sole collateral required.

**Benefit (net of loan):** This is the net amount of benefit after the loan has been paid off from the death benefit. GBFGPreservation® is structured around what economic benefit is right for each client's needs.



GBFGPreservation®

Current Cost of Borrowing

Sample Couple (52)									
YR	Premium Paid by Client	Premium Borrowed	Rate of Borrowing	Interest Paid by Client	Interest Borrowed	Cumulative Loan (EOY)	Policy Collateral Value	Collateral Required From Client	Benefit (net of loan)
1	0	838,495	4.000%	0	34,346	881,226	545,024	339,119	20,872,215
2	0	838,495	4.000%	0	70,084	1,798,190	1,346,459	457,683	20,747,454
3	0	838,495	4.000%	0	107,272	2,752,342	2,186,560	574,893	20,626,081
4	0	811,346	4.000%	0	144,856	3,716,658	3,062,837	666,124	20,511,320
5	0	554,600	4.000%	0	173,448	4,450,252	3,735,654	729,329	20,424,421
6	0	776,286	4.000%	0	212,280	5,446,581	4,746,413	718,197	20,413,429
7	0	776,286	4.000%	0	252,687	6,483,316	5,800,460	704,318	20,406,118
8	0	776,286	4.000%	0	294,732	7,562,097	6,892,842	694,287	20,395,797
9	0	776,286	4.000%	0	338,483	8,684,629	7,959,141	754,236	20,316,442
10	0	776,286	4.000%	0	384,007	9,852,685	9,332,970	552,330	20,504,193
11	0	0	4.000%	0	399,581	10,252,266	10,047,364	238,839	20,814,083
12	0	0	4.000%	0	415,786	10,668,053	10,785,247	0	21,131,258
13	0	0	4.000%	0	432,649	11,100,701	11,547,923	0	21,456,363
14	0	0	4.000%	0	450,195	11,550,897	12,240,459	0	21,693,781
15	0	0	4.000%	0	468,453	12,019,350	13,208,113	0	22,188,763
16	0	0	4.000%	0	487,451	12,506,801	14,199,625	0	22,692,824
17	0	0	4.000%	0	507,220	13,014,021	15,221,063	0	23,207,042
18	0	0	4.000%	0	527,791	13,541,812	16,273,981	0	23,732,169
19	0	0	4.000%	0	549,196	14,091,008	17,222,008	0	24,131,000
20	0	0	4.000%	0	571,469	14,662,476	18,562,824	0	24,900,348
21	0	0	4.000%	0	594,645	15,257,121	19,931,107	0	25,673,986
22	0	0	4.000%	0	618,761	15,875,882	21,332,687	0	26,456,805
23	0	0	4.000%	0	643,855	16,519,738	22,767,696	0	27,247,958
24	0	0	4.000%	0	669,967	17,189,705	24,038,445	0	27,848,740
25	0	0	4.000%	0	697,138	17,886,843	25,852,454	0	28,965,611
26	0	0	4.000%	0	725,411	18,612,254	27,697,852	0	30,085,598
27	0	0	4.000%	0	754,830	19,367,084	29,569,298	0	31,202,214
28	0	0	4.000%	0	785,443	20,152,527	31,463,332	0	32,310,805
29	0	0	4.000%	0	817,297	20,969,824	33,092,785	0	33,122,961
30	0	0	4.000%	0	850,443	21,820,267	35,468,350	0	34,648,083

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The above Economic Benefit Analysis depicts how the transaction will perform based on today's conditions and the assumption that all premiums and interest are accrued and the client is purely posting collateral.

The net-economic benefit, which is the death benefit minus the cost of acquisition (in this case repayment of the loan) is the far right column and demonstrates a steady long-term growth. The collateral to be posted in addition to the policy are the amounts shown in red. These are cumulative numbers on an annual end-of-year basis. It is what the client has "at risk".

Below is a risk analysis comparison of varying interest rates and their impact on the amount of collateral needed. In addition it shows the impact of paying 5 or 10 years of interest.

Client Collateral Comparison

Sample Couple (52)						
YR	Premium Borrowed	Current	Regression	Alternative	5-Yr Interest Paid	10-Yr Interest Paid
1	838,495	339,119	339,119	339,119	304,773	304,773
2	838,495	457,683	457,683	457,683	353,253	353,253
3	838,495	574,893	574,893	574,893	363,191	363,191
4	811,346	666,124	666,124	666,124	309,565	309,565
5	554,600	729,329	729,329	729,329	199,323	199,323
6	776,286	718,197	618,426	824,337	262,088	0
7	776,286	704,318	580,608	943,258	346,805	0
8	776,286	694,287	682,896	1,095,129	462,393	0
9	776,286	754,236	896,181	1,348,703	677,475	0
10	776,286	552,330	750,701	1,374,964	662,903	0
11	0	238,839	304,625	1,311,308	555,930	0
12	0	0	0	1,263,723	462,393	0
13	0	0	0	1,233,310	383,232	0
14	0	0	0	1,317,554	415,763	0
15	0	0	0	1,173,904	217,254	0
16	0	0	0	1,056,491	41,645	0
17	0	0	0	962,294	0	0
18	0	0	0	892,990	0	0
19	0	0	0	988,378	0	0
20	0	0	0	754,414	0	0
21	0	0	0	560,279	0	0
22	0	0	0	404,234	0	0
23	0	0	0	290,489	0	0
24	0	0	0	421,337	0	0
25	0	0	0	94,145	0	0
26	0	0	0	0	0	0
27	0	0	0	0	0	0
28	0	0	0	0	0	0
29	0	0	0	0	0	0
30	0	0	0	0	0	0

Glossary

- 1) Current: Amount of collateral required from client if interest rates continue at current rate.
- 2) Regression: Amount of collateral required from client if interest rates at historical cost of borrowing.
- 3) Alternative: Amount of collateral required from client if interest rates at alternative interest rate.
- 4) 5-Yr Interest Paid: Amount of collateral required from client if interest is paid out-of-pocket for the first five years.
- 5) 10-Yr Interest Paid: Amount of collateral required from client if interest is paid out-of-pocket for the first ten years.

Many clients address the collateral and benefit piece in their own way. Some will post collateral and prefer not to contribute to the transaction at all, leaving their confidence in interest rates and

crediting rates. Others may wish to pay some of the interest or even some of the premium. If they do this they will see a reduction in the amount of collateral posted and in some cases a more stable and better long-term benefit. One of the critical components is having the flexibility in the lending package so those decisions can be made on an annual basis and not upfront.

## **Conclusion**

The benefits of life insurance in the estate plan of an affluent individual are significant: guaranteed, tax-free liquidity at death that can protect and preserve the assets for the designated beneficiaries. The acquisition of that insurance can create liquidity issues and tax-implications, which can erode the long-term benefit an insured is trying to provide. A properly designed and executed traditional premium finance solution as described in this paper can bridge the concerns of a client during their lifetime with the needs of their estate at death. There are, as with any sophisticated transaction, risks, but the risks in this transaction are well defined in advance and as a result, the client is in a position to plan for and prepare for any implications that those risks may have on the long term viability and benefit of the solution. The balance of interest rate risk and insurance carrier crediting rate changes, weighed against the certainty of estate and death taxes makes this a very effective strategy to meet the liquidity needs of the estate.