

Life Insurance Premium Finance: An Alternative Strategy

By Steven Shepard

Assume for a moment that you are an individual who needs a substantial amount of life insurance. It may be for estate tax purposes. Or it could be to equalize your estate between those children who will continue a family business and those who are not active in the business at all. The need for additional insurance has been established and the application has been completed. Your agent has asked you the next key question: How do you want to pay the premium for this coverage? Good question. There is no free lunch.

You could elect to pay the premium with cash from current income flow. You might also consider a premium-paying concept called split dollar in which a business you own advances the premium and takes a security interest in the policy to make sure the business is paid back either during your life or at your death from the death benefit.

In the present low-interest-rate environment, you may have heard about the concept of premium finance. Premium finance uses a recourse loan or a series of recourse loans from a commercial bank to pay the premium on a life insurance policy. Let's take a look at this concept that has gained popularity in recent years.

Generally, banks are willing to provide premium finance for only their more affluent customers. Banks usually limit such loans to customers who have at least \$5 million in assets. Often the minimum loan will be \$1 million over the loan term. For example, if the loan term was 10 years, then you would have a minimum loan requirement of \$100,000 per year for the 10 years. Typically, the premium is paid for a limited number of years rather than for the balance of the insured's life.

Who is an ideal candidate for premium finance? Generally, anyone with the minimum required amount of assets and an after-tax investment return that is 3 percent or more above the bank loan interest rate. If the interest on the loan climbs upward in later years, you should have a plan in place to pay off the loan with investment assets.

Is premium finance for everyone? Far from it. It has its place in financial planning, but only if a positive investment leverage is present. Is it good for you? Only the individual can decide that after considering carefully the alternatives and the advantages of leveraging the low interest rates we currently are experiencing.

Note: Specific tax or legal questions should be answered by your own tax adviser or legal counsel.

(MORE)

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