Financing Life Insurance: Understanding a Client's Needs And Designing for Them

Produced By: The GB Financial Group

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The most salient advantages of the financing of life insurance are the elimination of the gift taxes otherwise required and the 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: living expenses, objectives for business growth or other long-term plans, versus the need 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. <u>Determining the net economic benefit.</u>
    - 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, than being monetized to pay insurance premiums.

2. <u>What is the health of the insured?</u>

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 provides the client with the insurance coverage needed, requires minimal liquidity to fund the life insurance policy, while reducing or eliminating gift taxes. 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.