THE (NOT SO) SECRET TO PREMIUM FINANCING

A loan can help your high-net-worth clients get the coverage they need without missing out on other investment opportunities.

Most agents catering to the high-net-worth segment are more than insurance salesmen — they are trusted advisors. As such, the most successful agents understand the extent to which their clients grew their net worth on the basis of leverage.

Many of these agents are utilizing an important tool for selling more life insurance, and it's one you may not know about. For more than 20 years, high-net-worth individuals have been successfully using leverage to acquire the life insurance they need. If you're not using this planning tool, you should be, as there are many successful brokers out there who are.

HOW DOES IT WORK?

Those who don't understand the true benefits of life insurance premium financing worry this is a tool dependent on interest rates or policy performance. But even when interest rates have been high and markets have been shaky, financially savvy brokers have been closing deals by funding life insurance premiums.

Why? Because in order for high-networth individuals to continue to grow and protect their wealth, they need to take advantage of leverage and actively look for investment opportunities that yield returns greater than the cost of capital. In other words, many need life insurance to address inheritance, business and tax issues, but they'd prefer to keep the funds they would spend on life insurance premiums in investments that yield more profitable returns.

With a currently strong economy and with rates hovering at all-time lows, premium financing life insurance makes more sense than ever.

The reason? Retained capital.

In this instance, retained capital is the amount of money a client can hold on to — and ultimately invest elsewhere — by paying interest on a loan that covers the cost of a premium versus paying the premium itself. Many high-net-worth clients report that they earn 10 percent to 15 percent or more on their money. If that's the case, why take funds out of profitable investments in order to pay a premium?

But let's be clear. Premium finance is not a gimmick. It is not free insurance. It never was and never will be. It is not a play on the potential arbitrage between policy crediting rates and interest rates. Your client will have to pay interest to a lender and will have to post collateral equal to the difference between the cash surrender value of the policy and the loan balance. It is simply a tool to help your clients reduce the initial out-of-pocket expenses relating to the purchase of a life insurance policy and a way to keep their money working for them in their investments of choice.

TO FINANCE OR NOT TO FINANCE?

To better understand what an asset premium financing can be, we have to look at the potential profit our clients would lose out on if they don't use it. In other words, the lost opportunity cost. So, let's take a look at the numbers and consider the lost opportunity cost of paying a $100,000 premium out of pocket.

If an individual truly earns 10 percent on the funds he would use for a premium payment, then he would lose the opportunity to grow his net worth by $10,000 if he were to pay the premium himself. Utilizing the benefits of premium financing, if the client finances the $100,000 premium at 5 percent interest, his out-of-pocket cost in year one is $5,000, and his retained capital is $95,000. That client could re-invest the $95,000 in a vehicle that returns 10 percent and end the year with $104,500 and a life insurance policy to protect those assets. Over time, this growth compounds. This is the power of premium finance!

THE TRUE COST OF A PREMIUM

Retained capital and lost opportunity costs are not the only reasons to consider premium financing. What is the true cost of a client's premium payment? Again, let's assume our client

has agreed to write a check for the $100,000 insurance premium. From where will those funds come? What if our client has to liquidate assets and pay capital gains taxes? The actual "cost" of the premium payment just increased from $100,000 to $120,000.

Now let's assume the insurance policy is held in trust. Unless clients have enough Crummey beneficiaries to utilize their annual exclusions, they may have to dip into their lifetime exemption or pay a gift tax of roughly $40,000. That would increase the client's premium payment from $100,000 to $160,000! Compare that to financing the premium at just five percent. The true cost of paying the premium is more than the client bargained for.

WHO ARE YOU LOOKING AT?

Know your audience. Premium financing can be a great tool for selling more insurance when offered to the appropriate person. Traditionally, premium financing has been a planning tool that works well for individuals with significant wealth and highly appreciated assets. It can also be a viable strategy for mid-market, highincome-earning clients who demonstrate a need for life insurance, for estate preservation or estate creation, and an ability to service debt associated with premium financing. When the need and ability are there, premium financing can be for borrowers from many walks of life.

You should also consider premium financing for clients who are looking to purchase life insurance without liquidating other investments or changing spending; who don't like traditional methods of life insurance payments; or who have trust-owned life insurance and want to reduce annual gifting requirements or save on possible gift taxes.

Most importantly, you should only finance those life insurance policies that best suit a particular client's insurance need. Premium financing works equally well with whole life, universal and indexed life products. Recently, there has been a market toward financing index policies. We have seen index policies positioned by agents as providing taxdeferred growth with death benefit protection and the potential of providing a pool of cash to use for retirement income, long-term care or other purposes.

THINK OUTSIDE THE BOX

Every opportunity for premium financing is unique. Just because one deal looks one way doesn't mean they will all be the same. For that reason, brokers should be creative in how they think about premium financing. Not only are brokers using premium financing for estate and business succession planning, but they are also using it with buy/sell agreements, key-man insurance, executive benefits and company owned life insurance. There are also some additional outside the box sales concepts that take advantage of premium financing:

Financing in-force policies. This can free up cash flow for new insurance or other investment opportunities.

Saving rated cases. The death benefit is often dialed-down to coincide with the original premium quoted. Financing the rating allows clients to purchase the amount of death benefit they actually need.

Paying off internal policy loans. This infuses cash back into policies and makes them stronger performing assets.

Creating a line of credit. Clients can pledge cash surrender value to create a line of credit against which they can draw.

Finding a term alternative. By capping interest payments, clients can purchase permanent coverage now and defer costs.

Every premium financing program is customized for the specific situation. Don't be afraid to think creatively; if there's a need for life insurance and an ability to service debt, there's an opportunity for premium financing.

If you haven't been using premium financing as a tool to help you close deals, you're missing out on your share. Think of premium financing as one of the many tools in your arsenal and as the element that makes you a true advisor to your clients rather than a salesperson. A good understanding of the benefits of premium financing just might be what sets you apart from the rest.

-Recently published in Life Insurance Selling Magazine.

After realizing a need for a conservative approach and customer-focused premium finance outlet for today's affluent marketplace and their advisors, CDP Insurance Services was started by 21 year industry veteran and premium finance specialist Michael Moore, CLU, ChFC in 2017.

Michael's previous industry experience as the west coast sales vice president for the largest North American lender of life insurance premium, coupled with an extensive life insurance sales pedigree, provides his clients with the knowledge and peace of mind that is crucial in today's complex financial planning climate.