moneyinsights
Accelerate - Optimize - Innovate

By Rod Zabriskie

Premium financed life insurance is an arrangement that allows high income and/or high net worth individuals to borrow money from a lender in order to pay for the many benefits of a life insurance policy. Simply stated, the strategy can provide for one or more of the following goals:

1. Create a new asset using leverage
2. Retain capital for investing
3. Produce a large death benefit for estate planning needs
4. Generate a tax-free stream of income

Let’s explore each of these goals separately.

Create a new asset using leverage

Many of us are comfortable with the idea of using leverage to invest in real estate, start or run a business, or increase the return on a myriad of different investments. Leverage allows us to expand the reach of our dollars far beyond what we could otherwise accomplish.

Premium Financed Life Insurance is just another way to do the same thing. Funding the proper amount of life insurance can cost tens, if not hundreds of thousands of dollars. Paying the premium upfront—or in installments—can be a tough ask when that money is already in use in other capacities. Pledging collateral in lieu of paying premiums and interest offers families many benefits: maintaining control of their assets, minimizing opportunity costs associated with payments, and minimizing gift taxes. This minimizes the out-of-pocket expense normally incurred when paying life insurance premiums.

In summary, Premium Financed Life Insurance is designed to preserve liquidity and save you substantially more money compared to paying for premiums out of pocket. Additionally, this strategy grants you the flexibility to plan for estate taxes and retirement income, while maintaining control of your assets and cash flow.

Retain Capital for Investing

As the old saying goes "cash is king." This is particularly true when it comes to investing. One of the primary benefits of utilizing premium financed life insurance is the ability to keep more money in your pocket to take advantage of potential investment opportunities. Opportunity cost is defined as the profit lost when one alternative is selected over another. By using the bank's money to fund the policy, investors are able to avoid that opportunity cost and obtain the desired life insurance benefits without sacrificing returns in other areas of their financial world.

Produce a large death benefit for estate planning needs

Estate taxes and other expenses associated with wealth transfer can have a devastating effect on the wealth created and built over an individual's lifetime. Unfortunately, most successful people are so focused on creating wealth that they have little time or attention left to focus on wealth preservation. Without proper planning, estate taxes and transfer expenses frequently require the forced sale of family assets and businesses at a substantial discount. For obvious reasons, this could have a devastating effect on the amount that is ultimately passed on to the next generation.

Premium Financed policies grant wealthy families the ability to leverage a life insurance policy that provides the liquidity needed for estate taxes and estate transfer.

Generate a tax-free stream of income

When faced with the many options for creating income in retirement, not all are created equal. As mentioned in point one above, a leveraged life insurance policy can be one of the most efficient ways to not only create income, but tax-free income in retirement. Imagine keeping your investment dollars where they are, posting them as collateral for a loan to create a tax-efficient life insurance policy, and letting them do the heavy lifting for creating a substantial amount of tax-free income in retirement. That's the power of Premium Financed Life Insurance. And, the beauty of it is that we don't have to decide today which strategy we'll be using. In other words, the cash is available for income, but to the extent we don't use it for income it generates a larger tax-free death benefit for our heirs.

One of the most powerful things about tax-free income from a life insurance policy is that it is much more flexible than the traditional government-sanctioned retirement plans. With the life insurance, we don't have the same age- and income-related restrictions. Nor are we forced to start taking funds after age 72. We have much more flexibility, and because we can use leverage to create the asset to start, it is arguably the best retirement income tool available.

How Premium Financed Life Insurance works

Premium Financed Life Insurance uses existing available assets to provide you with necessary insurance benefits while limiting your financial liability. The first step is to establish a trust or other bankruptcy-isolating entity (LLC, FLP, etc.). Next, the trust borrows money from the lender and secures the loan with the cash value of the life insurance policy. Additional collateral may be necessary to secure the loan, but the trust acts to limit your liability. You have the flexibility of providing collateral in the form of cash, bonds, securities, and other liquid assets (other forms of collateral can be considered on a case-by-case basis). In order to further reduce out-of-pocket costs, we typically arrange for all related expenses to be rolled into the loan where appropriate. In many cases, we arrange for some amount of out-of-pocket outlay to balance against the outside collateral required.

Over approximately 15–20 years (depending on the performance of the policy), the cash value grows and accumulates. The loan is then repaid from the policy cash values, and from that point forward we have access to use the policy for retirement income, among other beneficial ways to use the policy. When the insured passes away, the death benefit goes to the trust and is used to cover estate taxes and estate transfer expenses.

To learn more, visit us at www.moneyinsights.net