PREMIUM FINANCE

RISKS & CONSIDERATIONS

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TRUTH AND TRANSPARENCY™

PREMIUM FINANCE
RISKS AND CONSIDERATIONS

Risks -- what risks? Isn't premium finance like free insurance?

Not so fast. Before signing those documents, keep the following considerations in mind.

Our belief is that premium financing gives people the ability to own the amount of life insurance they need, instead of the amount they are willing to pay for. This does ***not*** equate to free insurance.

There are several risks and considerations you need to take into account before moving forward with a premium financed transaction. These include personal, policy, lender, systematic and unsystematic risks.

PERSONAL RISK

To start, a change in one's personal financial situation that could negatively affect income or net worth. Though not a major risk, you should consider this because banks will review personal finances annually -- in addition to assets posted for collateral -- in order to make sure they still qualify for the loan amount assigned.

Net Worth | The net worth of the insured or guarantor must be at least $5 million for many carriers -- and the sweet spot, in my experience, is generally $25 million and up.

Liquidity | Liquidity is a measure of the client's ability to post the required collateral and easily access the funds to pay off the loan if needed. Regardless of the policy's cash value, banks will want to see some amount of additional liquidity. As a rule of thumb, it is easier to secure financing for a borrower with a $20,000,000 net worth and $5,000,000 of liquidity than one with $50,000,000 of net worth and $1,000,000 of liquidity.

Collateral | If an initial shortfall exists, where will the collateral come from to secure this shortfall? More importantly, does your balance sheet show the ability to manage the future collateral needs of the plan? The collateral that the borrower posts in addition to the insurance policy could potentially be at risk if the loan is called and is unable to be repaid or refinanced.

(Policy underwriting and other loan requirements must also be met.)

POLICY AND LOAN RISKS

Policy Performance And Interest Rates | There is always the possibility that the policy will not perform as projected and the cash value will be lower than expected. So, what happens if the policy performance does not meet expectations? What if interest rates rise? How does that affect the way the plan works? And, what will this do to the long-term projections?

There are loose correlations between interest rates and policy performance. For example, when interest rates go up, policy performance can also go up. However, if they remain low, policy performance can also stay low. On the flip side, if interest rates go up, this could cause the loan balance to exceed the value of the collateral and create additional collateral requirements (depending on plan design) in order to keep the policy in force.

Lender And Renewal Risks | Will the bank that extended the loan still exist throughout the duration of the plan? Only select banks will participate in this type of transaction, and it is important to identify credible institutions that will not only be around for the duration of the plan but also understand how these types of transactions operate.

Can the loan be called if the cash value of the policy doesn't perform well and additional

collateral isn't met? If the policy doesn't perform as well as the loan, could additional collateral be required in order to repay the loan? Absolutely. These are factors that need to be considered and discussed during the initial design of the plan, rather than found out once the plan is already in place.

SYSTEMATIC AND UNSYSTEMATIC RISKS

Systematic Risks | According to Investopedia, systematic risk is defined as "the risk inherent to the entire market or market segment. Systematic risk, also known as 'undiversifiable risk,' 'volatility,' or 'market risk,' affects the overall market, not just a particular stock or industry. This type of risk is both unpredictable and impossible to completely avoid." In premium financing transactions, the underlying investments in equity or bond-based indices inherent to the transaction are the main engines to provide growth and performance to the policy in play. This type of risk can also be viewed as how all of the risks work in concert with one another.

Unsystematic Risks | Investopedia defines unsystematic risk as "specific risk" or "diversifiable risk." This can be reduced through diversification of factors such as life insurance carriers, policy types, lenders and even the adviser(s) working on the case. For example, is there an inherent legacy risk in the transaction? In other words, will the adviser you are working with still be there tomorrow, or is he/she on the way out of the business with no plan in line for business succession?

While premium financing is a complex process with various nuances, it can offer incredible benefits and value for the appropriate client. It is important to work with an experienced team of qualified financial, legal and tax experts when implementing this strategy for your clients.