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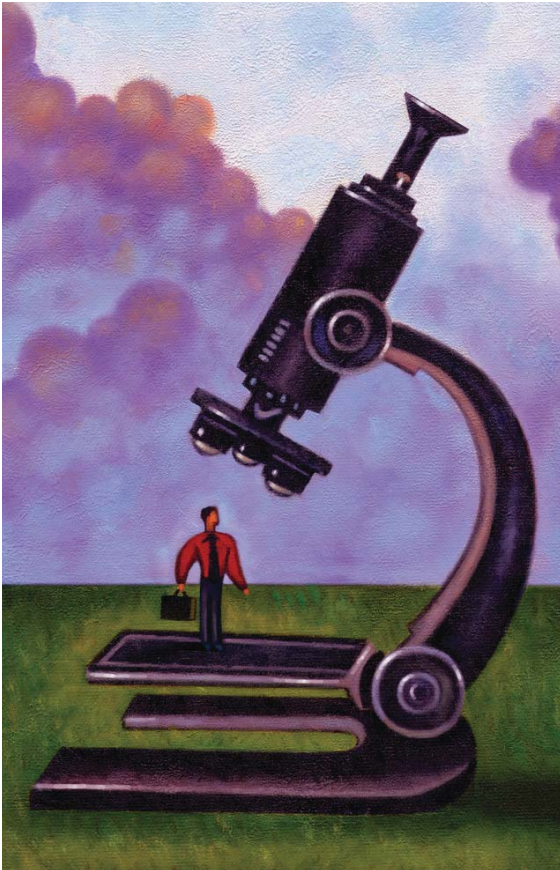
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Premium Financing in the Wake of the Credit Crisis

Standards Rise, Criteria Have Changed

BY ANDRE BLAZE

Securing financing to pay life insurance premiums used to be easy and noninvasive. Lenders took unaudited personal financial statements without question. Income was not verified to demonstrate the borrower's ability to service the loan. And the requirement to post additional collateral was almost unheard of. Sound familiar? Competition was fierce among premium finance lenders, allowing some to focus on simply making loans rather than making financially sound ones. The credit crisis hit some borrowers hard with nowhere to turn. Several lenders stopped providing financing, and those that continued were forced to take a good look at their lending practices.

Although financing is still obtainable, lenders are now asking more questions. Today, a back-to-basics approach is being implemented by lenders to ensure profitability and their capacity to price risk properly. Their ability to underwrite loan risk is key in determining the loan's pricing, which in turn allows lenders to stay committed to providing financing to pay life insurance premiums. Additionally, producers and advisors are also becoming more aware of what lenders are requiring for loan underwriting, which promotes better communication to their clients about a premium financing strategy.

So, what is a premium finance lender looking for when pricing a loan? Lenders today are looking at the borrower's:

- Credit history.
- Ability to repay the loan.
- Ability to pay loan interest.
- Ability to secure collateral.

Let's discuss these in more detail.

Credit history

Consumer credit has become increasingly more important, as it should be. Lenders want to lend money to those who have proven their ability to honor their financial obligations. However, not everyone has perfect credit. Additional fees and higher spreads may be charged to those who have less than perfect credit but are still considered lendable risks. Note: It is important to be aware of the many loan programs and lenders available in the premium finance marketplace.

Ability to pay the loan when due

Many types of premium financing loans are available. Each loan has its own terms, rates and costs. In addition, some have a stated number of term years with the ability to renew, while others are considered "call loans." Naturally, should the insured die before the loan period ends,

the loan is always repaid from the death benefit of the life insurance policy. However, to address loan repayment prior to death, it is a prudent practice to reserve capital earmarked for loan repayment in the future. The industry refers to this as an "exit strategy." It is interesting to note that when traditional premium financing is implemented properly, a natural exit strategy exists.

Example: Mr. Client would have paid an annual premium of \$500,000, but now his fractional cost is reduced to a loan interest payment (assume 7 percent, or \$35,000). The remaining \$465,000 is retained by the client. This retained capital is allowed to grow over time. The future value of this retained capital becomes the natural exit strategy. Other exit strategies that can be considered include GRATs and installment sales.

Ability to pay loan interest

Before the credit crunch, it was a common practice to illustrate not only the borrowing of capital to pay life insurance premiums but also the borrowing of loan interest for an extended period. Lenders today are taking a closer look at the borrower's ability and willingness to pay loan interest. Extending credit to borrow loan interest is not readily granted. In the event it is granted, the term of accrual must be manageable and realistic.

Ability to secure collateral

Premium finance lenders are very concerned with loan risk exposure, primarily loan default. Although personal guarantees will allow a lender to seek assets in the event of default, it is a slow and costly process. Therefore, lenders are seeking to collateralize their premium finance loans fully. This reduces the costs associated with recovering capital in the event of loan default. Lenders typically accept cash, bank letters of credit, securities and cash surrender values of other life insurance policies. Some lenders accept the full face value of these accounts, while others may discount their value.

Example: The price movement volatility of a security may require the lender to discount its present value for collateral purposes. Some lenders may also accept real estate as a form of collateral. Once

again, in order to make an informed decision, it is important to know how the lender views collateral and what options are available with other lenders.

Conclusion

Securing a premium finance loan in today's credit environment requires more due diligence than in the past from both the lender and the producer. Producers and advisors are recognizing that there is more to recommending a premium finance strategy than just the discounted outlay. Among the myriad of lenders and the loan programs they offer, it has become more difficult to ensure that the best loan program is being recommended to the client without being aware of the other programs that are available. Producers and advisors are freely accepting this liability without fully understanding that it exists.

There are many loan program promoters but only a few organizations dedicated to providing premium financing direction to the industry. Still fewer are those companies capable of providing custom financing designs that can be used for estate and business planning and also recognized as experts.

The tightening of credit within the industry has further strengthened traditional premium financing as a valid tool in purchasing life insurance. Know your client and choose your expert when it comes to premium financing, to ensure that you have all your bases covered. [INN](#)

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