Preserving Your Financial Legacy with Life Insurance Premium Financing

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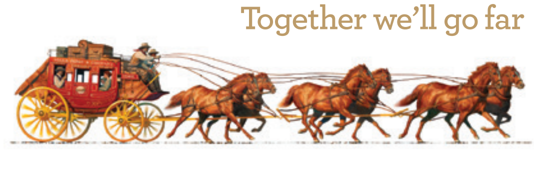
In this white paper

Together we'll go far



Preserving Your Financial Legacy with Life Insurance Premium Financing

For many high net worth individuals, life insurance can offer numerous benefits, including the potential for a tax-free death benefit that can protect their loved ones from bearing a large financial burden. This generally favorable tax treatment also means life insurance can be used for estate planning or business succession planning. However, life insurance policies with sizable premiums may create a liquidity issue of how to pay the high premiums required for these policies.

Borrowing strategically, as part of your comprehensive wealth plan, can align with your financial goals, including optimizing your cash flows, maximizing tax efficiencies, and realizing important estate financial planning goals. As such, life insurance premium financing is an example of a powerful way to use credit in the wealth planning process. Bank financing to fund your life insurance premiums may provide a tax-efficient option that allows you to preserve your current cash flow, avoid liquidating your investments, and leverage your wealth to provide future benefit to your heirs or charitable causes. Implementing a suitable premium finance credit structure in a low interest rate environment also may present significant opportunities to lock in interest rates, up to 10 years in some cases.

The importance of life insurance in the planning process

Life insurance is central to your wealth plan, as it may provide peace of mind to you and your family in knowing that you have planned for the unexpected and have protected the future of those whom you most love. When properly designed, life insurance can be effective in addressing four critical wealth management objectives: wealth protection, liquidity, wealth accumulation, and wealth transfer. Life insurance can be used as a planning tool to achieve your goals and objectives in a tax efficient manner. In evaluating the need for life insurance, it is important to consider your financial goals and objectives in the context of your overall wealth plan.

A large life insurance policy that meets your financial objectives will often necessitate large premiums and require a payment strategy to help you stay on track with your financial goals. A policy owner can utilize various strategies, including combinations thereof, for funding life insurance premiums, as referenced in Table 1.

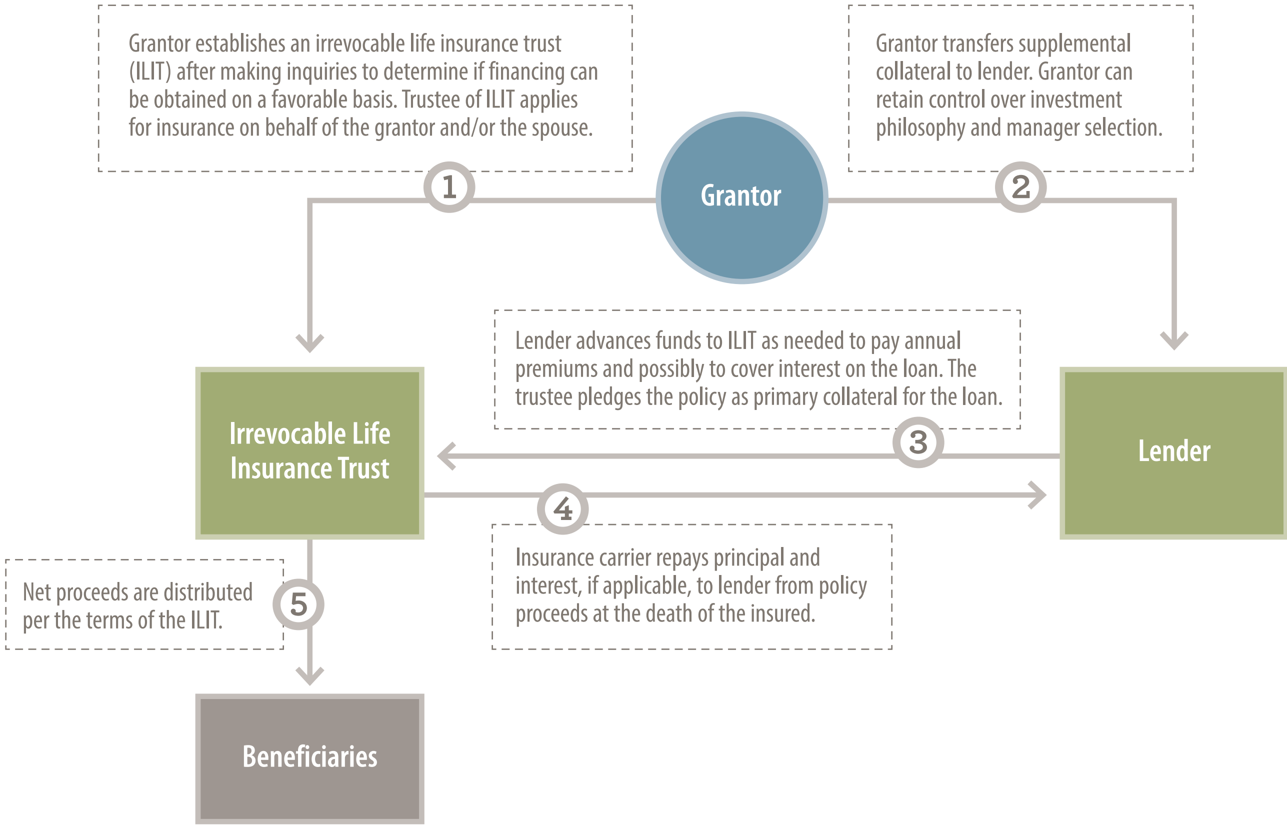
Table 1.

Gift	Lend	Borrow
Pay Gift Taxes "As You Go"	**Grantor Loan**	**Bank Financing**
■ Write the check ■ "Clean and simple": Gift tax is owed based upon any amount applied towards life insurance premium ■ No interest rate risk ■ Predictable cash flow ■ Heirs receive 100% of the life insurance death benefit proceeds if properly structured	■ Make annual loans to a trust to cover the premium plus the annual interest on the loan ■ Gift taxes may apply to additional interest payments ■ Loan interest is based upon Applicable Federal Rate (AFR) ■ Interest rate risk: – Can't lock in low loan rate because this is an annual transaction – Gifting occurs every year because interest is being paid every year – Single ("bullet") loan scenario can mitigate interest rate risk ■ Unpredictable cash flow ■ Works well with Return of Premium (ROP) feature of life insurance	■ Borrow funds annually from lending institution ■ Interest may be paid as accrued with proper structure ■ Interest rates based upon LIBOR or other rate plus a spread ■ Borrower must qualify for the loan and often re-qualify from time to time ■ Cash value products can help with issues regarding collateral requirements ■ Fixed rate hedging solutions available

Source: Wells Fargo Private Bank

How Life Insurance Premium Financing Works

When arranged properly, life insurance premium financing can be a valuable funding alternative for your estate plan.



Source: Wells Fargo Private Bank

Why finance your life insurance premiums?

Life insurance premium financing is a viable alternative to consider after thoroughly exploring the three options outlined in Table 1. Implementing a strategy to secure bank financing may be quite useful by allowing you to borrow funds to pay your life insurance premiums with the underlying policy value serving as collateral for the loan. A life insurance premium financing strategy can help preserve your current standard of living since you don't need to access your cash flow to make large premium payments. It also may allow you to avoid liquidating investments and related capital gains tax consequences in order to fund those payments.

Additionally, life insurance premium financing may provide a tax-free benefit that is not included in your estate and further help protect your net worth by facilitating the transition of your financial legacy to future generations. It may also provide a secondary positive arbitrage between the earnings crediting rate on the cash value growth and the carrying cost of the loan.

When positioned properly, it may be possible to experience accelerated equity buildup with the insurance policy over time, resulting in greater sustainability and ultimately greater future economic benefits to your beneficiaries.

Before making a funding decision about life insurance premiums, you should discuss the options available to you with your wealth advisory team and tax and legal advisors. A final decision about the funding option for life insurance will require evaluation of your specific financial circumstances and needs.

Considerations of life insurance premium bank financing

As with any borrowing strategy, there are risks associated with life insurance premium financing. We encourage you to discuss these issues with your advisors before you make any decisions:

- There is an interest rate risk assumed by the policy owner if the interest rates on the bank loan are higher than initially projected after the initial fixed rate period. As mentioned earlier, interest on the loans may be based on Applicable Federal Rates (interest rates published monthly by the IRS for federal income tax purposes) or LIBOR (London Interbank Offered Rate).
- There may be a need for additional collateral if the policy's cash values are lower than initially projected due to poor policy performance.
- Additional gifts may be needed to provide capital to the trust to fund unexpected higher interest payments and/or premium payments.
- Annual monitoring of the policy and the premium financing is strongly encouraged to make sure that the transaction is still meeting the policy owner's needs and that adjustments are made as needed.

Similarly, it's important to evaluate the life insurance policy regularly to make sure that the policy still fits the strategy of financing the premiums. It's crucial to have a discussion with your wealth advisory team and tax advisors about exit strategies and how you will repay the loan:

- You can fund the trust to pay off the loan.
- The trustee may use the cash surrender value to pre-pay the loan in whole or in part.
- It may also be possible to combine your borrowing strategy with your charitable giving initiatives through a charitable trust.
- You can refinance the loan.

Is life insurance premium financing right for you?

As you see in the example, John fits a typical profile of someone who may benefit from financing his life insurance premiums. John has substantial net worth and personal liquidity, but also sees a need for life insurance as part of his estate plan. Given his large life insurance policy, he has significant life insurance premiums that are required on a structured payment timeline. John is interested in obtaining a tax-efficient rate of return while also understanding the associated risks in financing his life insurance premiums.

Example of an individual profile and the use of life insurance premium financing

John is the retired chief financial officer of a large U.S.-based publicly traded pharmaceutical company. John has a strong desire to protect his financial legacy and is concerned about how to preserve his family's liquidity against future estate tax exposure. John has exhausted his lifetime gift tax exemption, but is seeking advice on a tax-efficient wealth transfer solution. Working closely with his family's estate planning attorney, his wealth planning, banking, and insurance advisors developed a long-term liquidity solution by creating an Irrevocable Life Insurance Trust (ILIT) to hold three life insurance policies. Since John has exhausted all of his gift tax exemption, if the ILIT were to self fund the annual premiums on the policies from contributions made by John, each of those contributions would be subject to gift taxes. To mitigate future gift tax exposure, John's wealth team recommended a custom non-recourse (to mitigate potential incidence of ownership) premium finance credit facility to fund the annual premiums due on the life insurance policies. The loan will accrue interest in order to mitigate any gift tax exposure on future contributions to the ILIT and the net insurance death benefit will not be included in John's gross taxable estate. By thoughtfully evaluating John's financial circumstances and understanding his goals, John's wealth advisors were able to suggest a solution that solved a family planning issue, potentially saving John and his family millions of dollars in future estate taxes.

Source: Wells Fargo Private Bank

Conclusion

A life insurance premium financing strategy may provide a unique solution for high net worth individuals who are seeking a tax-efficient way to preserve their financial legacy. In order to successfully implement this wealth transfer solution as part of your overall wealth plan, it is important that you engage your team of wealth and tax advisors. Given the complexities with this solution, you should have a thorough understanding of life insurance premium financing. Your banking advisor and the Private Bank Specialty Finance can provide ongoing monitoring of aspects such as annual life insurance policy reviews and collateral monitoring. By working closely with a competent and experienced advisory team, you will be well positioned to make a sound decision to determine if financing your life insurance premiums is the appropriate option for you as part of your plan to preserve and transition your wealth to the next generation.

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