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Premium Financed Policies

By Steve Shorrock, ChFC, CLTC, FLMI

The financing of life insurance premiums has long been a common practice in the estate planning market, since the economic rationale for purchasing insurance for wealthy individuals is almost always about liquidity. Premium financing allows an otherwise illiquid estate to make provisions for estate taxes and other final expenses without having to liquidate assets—either currently or at the death of the insured.

As a vibrant secondary market for in-force life insurance developed in the early part of the last decade, capital became available for more speculative approaches to premium financing, including "non-recourse" programs (where the policy itself was the only collateral) as well more questionable schemes whereby premium finance was used to effectively acquire policies for investment purposes from their inception (commonly referred to as "STOLI").

Financial advisors were delighted with the access to premium financing as large face policies on older individuals—almost of all of them financed—quickly became the fastest growing segment of the life insurance business. Not surprisingly, most of these policies sooner or later were presented as potential life settlements and many were in fact settled during the period from 2006 to mid-2008.

There was a good deal of interest in these policies by funders due to the belief that insurance carriers were underpricing policies on older insureds at issue.

While the impact of the financial crisis was painful for the life settlement market in general, the market for premium financed policies was virtually decimated. Legislation, regulation, media attention and litigation around the issue of insurable interest caused most of the investors who remained active in the market to shun all financed polices—even those where the financing was approved by the issuing carrier and insurable interest at inception clearly existed.

Fortunately, some of the more sophisticated buyers have recognized that not all financed policies are problematic and there are now active buyers for "clean" financed cases. To fall into the "clean" bucket:

• The original owner of the policy (whether an individual or a Trust) must have a clear an valid insurable interest in the life of the insured;

• The financing must have been disclosed in the application for insurance;

• The insured's true net worth and medical status must have been fully disclosed in the application;

• The financing must not include any sort of "put" option, first right of refusal or any restrictions on the sale of the policy...and

• There must be a clear record of all premium payments, including the source of the funds

If you've been on the sidelines for the last couple of years, now's the time to re-examine your book of business to determine if you have any clients who would be good candidates for a life settlement as good cases are finding offers once again. At Veris Settlement Partners, we have more face amount in closing than at any point in the past two years.

The current market is insureds age 75 and above, or younger should they have severe health conditions. Life expectancies of 12 years or less as well as efficient premiums. There generally needs to be a change in health after policy issue in order to find value in the secondary market.

Financed policies that have been previously sent out to market may now find buyers if they meet the criteria above.

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